

2006 BUDGET & OUR VIEW ON THE UK ECONOMY

Gordon Brown's Budget speech in March contained all the usual meaningless rhetoric about encouraging enterprise and the market economy. In reality however, Brown underlined his belief that there is no problem which can't be solved if only more taxpayers' money and state intrusion is aimed at it.

A letter published in the Financial Times shortly after the Budget accused Brown of reducing the Budget speech to a pantomime. We fully concur with this point of view. It is pointless listening to and watching the speech, because it is no longer an accurate portrayal of the Budget measures.

According to calculations by the Institute for Fiscal Studies, of the 45 policy changes signalled in the Budget, only 17 were properly dealt with in the speech. The 17 measures gave away £533 million a year. The other 28 measures barely touched on, or not mentioned at all, took away an estimated £780 million.

We regard it as fundamentally misleading and fraudulent not to give a proper review of the measures being enacted in the Budget speech, and what really underlines the seriousness of the omissions, is the fact that the rest of the speech is padded out with self congratulatory drivel.

We consider that some of the key Budget measures our clients should be aware of are as follows:

CHANGES TO THE PENSION REGIME

From the 6th April 2006 ("A day") the pension rules changed significantly. The changes have been presented as a simplification, but in the final analysis some areas have been simplified and other areas have been made vastly more complex.

The changes are far reaching and in exceptional circumstances, a taxpayer with earnings of up to £220,000 in a year may not have to pay any Income Tax if he or she has sufficient funds to contribute to a pension scheme.

Significant tax planning opportunities will exist for clients who have spare funds they are willing to contribute to a pension scheme.

Unfortunately however, the ability to backdate pension contributions that are made after the end of the tax year has now disappeared. Many of our clients have in the past used this provision so as to precisely eliminate or reduce their higher rate tax liability. It will now be necessary to make all pension contributions "in year" and in some cases this will mean estimates have to be used in determining the optimum contribution from a tax saving point of view.

For obvious reasons, the tax framework surrounding a pension regime should be very long term, and it is to be hoped that the new regime is not now tinkered with. We are not entirely certain that this will in fact be the case, and with Brown's obsessive desire to interfere and fiddle around with tax reliefs, there may be an argument for maximising the benefits of the new regime sooner rather than later.

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Gordon Brown had previously advised that people would be able to hold residential property in their pension funds. This attracted a huge amount of interest and the pension industry spent many millions of pounds gearing up for this fundamental change in the pension regime. In December 2005 however, Brown announced that residential property would not now be allowed in a pension fund as envisaged. This represented an astonishing U-turn and an atrocious breach of trust. As usual, no apology was forthcoming.

INHERITANCE TAX

Gordon Brown is obviously trying to give Inheritance Tax real teeth, and changes were announced in the Budget, without due consultation, which indicated that retrospective legislation will be introduced in the Finance Act which will negate tax planning carried out by millions of individuals to reduce their Inheritance Tax liabilities.

A huge amount of confusion has subsequently arisen with The Treasury claiming that only a tiny fraction of the population would be affected, and the accountancy profession claiming that several million people will be affected.

We do not know how this will be resolved until the Finance Act becomes law, but Brown's throw away line that Inheritance Tax only affects 6% of the population is somewhat disingenuous. The huge escalation in house prices means that this tax is potentially going to be imposed on a far higher percentage of the population and clients should be aware of this.

There are two conflicting arguments about Inheritance Tax. On the one hand there is the camp that says earnings are taxed, investment income which results from retained earnings is by and large taxed again, and that anything left on death should be exempt. The other camp takes the viewpoint that those who have accumulated sufficient wealth should be prepared to pay a final tax on their exit from this earth. We can actually see merits in both arguments, but in the case of the latter argument, only where the threshold above which the tax is applied is set at a sufficiently high level. Additionally, the imposition of one flat rate of 40% is illogical and there is a good argument for the tax rate to be scaled.

We consider that Brown has once again acted in bad faith and it appears that the new rules will apply to trusts that have already been set up, not just to ones that are being set up this tax year or in the future. Many people have spent a lot of time and money trying to plan for their childrens' futures and have effectively seen it all go to waste.

One commentator wrote that in effect, "Mr Brown has outlawed tax planning. By deciding that it is acceptable to make retrospective tax laws, he can effectively confiscate any amount of wealth he likes, at any time he likes."

Inheritance Tax planning is therefore an area that many clients should now consider carefully.

SHORTENING OF THE TAX RETURN SUBMISSION DEADLINE

Proposals were announced in the Budget that in just 2 years time the filing date for Income Tax Return forms will be advanced from the 31st January to the 30th November, ie. 2 months earlier. This change was proposed by Lord Carter, who was asked to propose measures to increase the use of online filing.

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For us effectively this means 22% less time to prepare and file your Income Tax Return form. No plausible reason has been advanced for the proposed change, other than it brings us more into line with international norms. We are of the opinion that it will in fact increase rather than reduce the Revenue's costs, as many more Tax Return forms will need to be submitted with estimates, which will then have to be amended.

No change is proposed at the current time for the payment dates of your tax, which will remain at the 31st January and the 31st July. Any taxpayer who has not filed by the 30th November will be liable for a fine of £100. Currently, approximately one million taxpayers are fined £100 each year for failing to submit their Tax Returns to the Revenue by the 31st January. It seems to us that a hidden reason for advancing the filing date is to increase the number of taxpayers liable to a late filing penalty. If the number of these people doubled as a result of the introduction of the earlier filing date, a further £100 million of penalties would be due to the Exchequer. This has all the hallmarks for yet another stealth tax.

LIMITED COMPANIES - £10,000 ZERO RATE CORPORATION TAX BAND

As predicted by us, the 0% tax band for small limited companies on the first £10,000 of profits has now been abolished. We advised that incorporation should not be undertaken for tax reasons alone, as we doubted that the 0% tax band would last very long. The introduction of the 0% tax band was a classic example of a Budget measure which had been exceptionally ill thought out, or not thought out at all. We were astonished when the 0% band was introduced, because it created such an extraordinary loophole, which millions of ordinary businesses could exploit. Many of these businesses will now face the complexities of disincorporation and the associated costs relating thereto. We wonder whether Gordon Brown took the time to pause for a moment, and realise the whole mess was his fault.

TAX CREDITS

We have previously pointed out how in our opinion the Tax Credits system is hugely flawed, with the system of provisional Tax Credits awards based on the previous year's income, inevitably leading to significant overpayments in hundreds of thousands of cases. As we predicted, the Revenue have been hugely unsuccessful in recovering overpaid awards (surprise surprise, the money paid out had been spent by the recipient) and some estimates suggested that £1billion of overpaid Tax Credits was irrecoverable.

So that the overpayments problem is significantly reduced, it was announced that from April 2006 onwards, increases in the Tax Credits claimants income of up to £25,000, would be disregarded when reviewing the provisional Tax Credit award. This represents a tenfold increase in the tolerance in the system. While we are pleased that the Tax Credit overpayment problem will be significantly reduced, we can't help thinking that a more appropriate response would have been to review the system completely. However, this would have meant that Gordon Brown would have had to admit the system was flawed in the first place and we are aware that he is incapable of ever admitting a mistake.

We actually believe that the increased tolerance in the system will permit some wealthy individuals to exploit a loophole by making significant pension contributions to reduce their income for Tax Credits purposes, and therefore be entitled to Tax Credits awards. Clearly this is absurd, but an inevitable result of Gordon Brown's obsession with interfering and redistributing wealth. As we have stated previously, perhaps he could consider taxing people less, letting them keep more of the money they have earned and thus avoid the necessity to employ tens of thousands of public servants to administer the Tax Credits scheme.

The online Tax Credits service turned out to be so insecure that it became subject to major fraud by criminal gangs. Employees of Network Rail and even the DHSS had their identities stolen. This resulted in the online service being closed down and no details of the amounts paid out as a result of these frauds has ever been made public.

VAT

The VAT registration threshold has been raised to £61,000. If you believe that your business is likely to reach this limit (based on the previous 12 months turnover) and you are not already registered, please contact us at your earliest convenience.

HM REVENUE & CUSTOMS CULTURE AND ATTITUDE

While this was not something that was discussed in the Budget, we feel it is appropriate to draw to our clients attention a significant change that has been occurring in the Revenue's overall culture.

This change in culture is evidenced in numerous areas of the Revenue's activities, and as more and more obligations and demands are placed on the taxpayer, the Revenue & Customs simultaneously seem to believe that it is acceptable for the quality of service they provide to taxpayers to deteriorate.

It is difficult to convey the daily frustrations that we experience dealing with the tax authorities. One example centres around the Revenue's extensive use of call centres. A significant proportion of our clients are locally based and in the past their tax affairs have been dealt with by local tax offices such as Aylesbury and Milton Keynes. Where problems or queries arose it was generally possible to phone the local tax office, speak to a Revenue employee in that office, and resolve matters as they had access to all the appropriate information and files.

Sadly, this is now no longer possible, and we now have to phone far flung call centres, wait in a phone queue, eventually speak to a Revenue employee who will only ever give you their first name, and then find out that they are unable to deal with the query without contacting the local tax office. We are not allowed to phone the local tax office ourselves, and instead have to rely on the call centre to phone them and ask them to contact us. Sometimes this system works!

This is merely an isolated example of the general deterioration of the service received, and the use of call centres has undoubtedly enabled the Revenue to make it harder for people to deal with their affairs.

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Where significant errors are made by the Revenue, such as the repeated failure to process information sent to them or where the Revenue have mislaid documents delivered to them, we are now urging clients to apply for compensation. We see no reason why clients should be forced to pay our time costs, which arise purely as a result of the Revenue's incompetence and inefficiency.

ECONOMIC VIEW

The UK economy has thrived since coming out of recession in the early 90's. Wild swings in inflation and growth have been avoided, the pound has been strong and a generally woeful performance of the Euro zone countries has enabled Britain to overtake France, Germany and Italy in prosperity, measured as GDP per person.

Gordon Brown likes to claim that he is solely responsible for this success. In reality, many of the reasons for this period of growth date back to before Labour came into power in 1997. The ejection of the pound from the European Exchange Rate Mechanism in September 1992 and the enduring long term benefits of Thatcher's unpopular labour market reforms in the 80's have been key components of the subsequent economic growth. Brown's decision in 1997 to make the Bank of England independent in setting interest rates was a bold reform, which has undoubtedly paid off handsomely.

We suspect however, that future economic prospects may not be so bright. Household spending is a hugely important factor for the UK economy, and consumption fuelled growth has come about at the expense of saving. The savings ratio has fallen dramatically, being 10% of post tax income in 1995 but totalling only 4.4% by 2004. This decline has been possible because of the huge increases in UK house prices, which rose by a staggering 180% from mid 1996 to mid 2004. Stagnation, or a fall in the housing market will inevitably slow the consumer boom. While Estate Agents, Banks and Building Societies and the numerous "property journalists" with huge vested interests, regularly tell us that the property market is buoyant, an OECD survey at the end of 2005 estimated that British property was among the most over valued in the rich world. Household consumers may well rein in their expenditure when the impact of higher energy prices coupled with the costs of debt servicing start to take effect. If, as we believe likely, house prices stagnate or fall, the reduction in consumer expenditure will be even more marked.

We are often accused of being pessimistic, and no doubt there is some truth in this. However, we do feel clients should be aware that the Utopian picture that Brown paints of the UK is not one that we recognise. Whatever your opinion of Gordon Brown's politics (an old fashioned tax and spend socialist) his devious and dishonest behaviour is in our view totally unacceptable, and the thought of him becoming Prime Minister fills us with dread.

Brown has been responsible for the following:

1. Raided pension funds for £5 billion a year and helped precipitate the pensions crisis.
2. Finally got rid of the Married Couples' Allowance and tax relief on mortgage interest.
3. Created the Tax Credits system, which is riddled with problems, and has the effect of massively increasing the proportion of the population subjected to means testing.

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4. Has presided over a doubling of the amount we pay in Council Tax.
5. Has presided over quintupling of the amount paid in Stamp Duty on property.
6. Invented the absurd £10,000 zero rate Corporation Tax band, and then abolished it.
7. Has created over 5 million more higher rate taxpayers by failing to increase the higher rate tax threshold by sensible increments.
8. Increased National Insurance contributions instead of increasing Income Tax (the effect is much the same) and claimed he hadn't raised taxes.
9. Sold nearly 400 tonnes of gold over the period 1999 to 2002 at sales proceeds of £3.5billion. This would now have been worth £7 billion.
10. Has attempted to spread propaganda by constantly using the word avoidance (legal), when he means evasion (illegal), concerning tax matters.

We are not members of any political party and generally consider UK politicians to be self serving, low calibre incompetents. Unfortunately, we are blighted with an economically illiterate and ineffective opposition party, and also an economically illiterate press, who are generally happy to regurgitate the spin emanating from the government. By and large, the press completely failed to point out how Brown had not mentioned in his speech how economic growth has slowed to a 13 year low, how productivity in the UK remains low, how unemployment is rising, how an estimated 8 million people in the UK are economically inactive, how the unreformed public services, particularly the NHS, are failing to improve their output in line with the countless extra billions of pounds of input, how the pensions time bomb is ticking away remorselessly, and how the UK competitiveness is declining in line with ever increasing red tape.

CONCLUSION

We sense that more difficult times lie ahead. Brown has had an easy ride raking in the VAT, Stamp Duty etc., which has flowed from consumers burdening themselves with what is often excessive debt.

This trend has to stop at some point. We have lost count of the number of people who claim that house prices will always go up and that interest rates will always be low. Experience dictates that one of the biggest mistakes one can make in life is to believe that "things won't change". They always do!

As always, we will endeavour to assist you as far as possible, so please don't hesitate to contact us to discuss your affairs. We would be interested to hear your views. Perhaps you are more optimistic than us!

