

BUDGET NEWSLETTER 2007

OVERVIEW

The 2007 Finance Bill will run to many hundreds of pages. It would be logical to think that there are therefore a great many changes which we need to bring to your attention. This is not however the case, and for the vast majority of our clients the 2007 Budget will have very little immediate impact.

The Chancellor's last Budget contained all the trademark Gordon Brown spin. The speech largely consisted of lavish self congratulation, mixed with the presentation of carefully selected statistics, in an attempt to make us believe that a Utopia has been created by Mr Brown's incessant fiddling in our everyday affairs.

Gordon Brown saved his crude headline grabbing announcement until the end of his speech. The basic rate of Income Tax will be cut from 22p to 20p in the pound in 2008. However, the abolition of the 10% starting rate – in other words doubling the starting rate from 10% to 20% - and the increase in National Insurance – means that for most taxpayers, total Income Tax and NIC liabilities will not vary greatly. The main beneficiaries here will be pensioners, who are not liable to pay National Insurance contributions.

The Budget was essentially a largely tax neutral affair – the giveaways were matched by the takeaways, and one observer commented in a national newspaper as follows:

“Brown's final Budget feels like being given a few quid by the burglar who has been robbing our homes since 1997”.

The few changes that should be brought to our clients' attention are as follows:

CAPITAL ALLOWANCES

- In 2008 major changes to the capital allowance system will be introduced. Capital allowances are the tax allowances on the purchase of plant and equipment and other capital items, and it appears that small businesses will be able to claim 100% first year allowances up to a prescribed limit from 6th April 2008 onwards.

However, full details relating to this are still not available, and clients should discuss their own particular circumstances with us, in order to maximise any benefits which might be derived from the new regime.

VAT

- The VAT registration threshold has been raised to £64,000 per annum. If you believe that your business is likely to breach the threshold (and you are not already registered), please contact us at your earliest convenience so that we can review your circumstances and advise you accordingly.

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ISA LIMIT

- It was announced that the annual ISA savings limit will be raised from £7,000 to £7,200. This is a desultory increase of under 3% in the 8 years that the ISA regime has been running! Don't hold your breath however, because this change won't be introduced until 2008 either.

SELF ASSESSMENT DEADLINE

- We are pleased to report that plans to shorten the deadline for submitting Self Assessment Tax Returns have been amended. The due date for Returns submitted electronically will remain at the 31st January. In addition, the enquiry window (the time in which the Inland Revenue can start an investigation into the entries on the Return) will now run for one year from the date when the Return is submitted, rather than for one year from the 31st January filing deadline. We consider this a sensible move.

SMALL COMPANY RATE OF TAXATION

- It was announced that the Corporation Tax rate for small companies is to be increased from 19% to 22% over a period of 3 years (an increase in liability of nearly 16%). This seems at variance with Mr Brown's claim that he wishes to encourage enterprise.

THE FUTURE

The Chancellor announced numerous measures which are to be enacted in 2008, 2009 and 2010. Effectively therefore, he tried to incorporate all of the major tax changes for the remainder of this Parliament into his 2007 Budget and he has left his successor with little or no freedom of action. This is a clear indication that Gordon Brown is a control freak, and we were not at all surprised to witness Lord Turner's recent savage attack on him. In the litigious age in which we live, we wonder whether Stalin's descendants could bring a case for defamation!

In our opinion, the 10 year Brown Chancellorship will be remembered mainly for the following:

THE PENSIONS CRISIS

In several previous annual newsletters we highlighted Gordon Brown's pension fund raid for some £5billion a year. This was announced in his first Budget in 1997. We were amazed at how he got away with this move at the time and this seemed to be due to the laziness of financial journalists, beginner's luck, and the relatively buoyant state of pension funds at the time.

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Ten years on, the chickens have now well and truly come home to roost. The Times 2 year battle under the Freedom of Information Act, to obtain papers relating to the advice given to him before the 1997 Budget resulted in this information recently coming into the public domain. Gordon Brown and his advisers tried to bury the news by leaking it out on a Friday afternoon after Parliament was in recess.

The pensions raid was a heist of premier proportions and in line with most people, we subscribe to the view that it was fundamentally wrong. It has taken a number of years for the consequences to work out fully and there have been many millions of victims of this folly.

Gordon Brown's right hand man, the odious Ed Balls (this individual will look you in the eye and swear to you that black is white) attempted to claim that the CBI had backed the changes to the taxation of pension funds in 1997. The CBI were so enraged by this claim, that they released papers showing this was clearly not true. Mr Balls had to retract his claims.

We do however still believe that the tax relief available on pension contributions is still by far and away the best tax break available for the vast majority of taxpayers. This is in spite of the fact that Brown did disadvantage pension funds way back in 1997.

A higher rate taxpayer can obtain 40% relief on pension contributions and quite possibly only pay 20% when withdrawing his pension. Bearing in mind that 25% of the pension fund can be taken as tax free cash, effectively the rate of tax paid on the pension becomes only 15%, with tax free growth in the pension fund in the meantime.

In our view, Brown's greatest crime was the fraudulent way in which he presented the change as a victimless crime. He could in fact have made a plausible case for his actions, if he had acknowledged at the same time that there would be consequences and both companies and individuals would have to increase their pension contributions to compensate. Sadly, he failed to do this.

TAX BURDEN

Most economists believe there to be a direct relationship between higher taxes and lower economic growth. The Item Club, a forecasting group, calculates that under Brown's Chancellorship, the share of household income spent on tax has risen from 33.6% in 1997 to 38.3% last year. Tax freedom day now falls at the start of June. This means that the average UK resident has to work a full five months of the year solely to pay their annual tax bill. The tax burden isn't just Income Tax and National Insurance, it includes VAT, fuel tax, alcohol and cigarette duties, airline tax, fuel duties, car tax, council tax and much, much more.

Some people may believe that the state should do more and different people will have different views as to what the "optimum" level of taxation might be. However, we can't help feeling that the UK will be potentially damaged in future. Other countries are trying to cut their tax burdens at the same time as our burdens are rising.

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In our opinion the problem of rising taxation has been compounded by the appalling value for money obtained from the huge increase in public spending. Public spending as a share of national income has risen from 37% to 45%, with £75billion a year spent on education and about £100billion spent on health. In spite of this, many state schools are so poor that responsible employers complain of chronic illiteracy levels among 16 year olds. The health system seems to be permanently unwell, with hospitals being closed and nurses sacked. Does anyone want to hazard a guess as to how much the Olympic Games will cost?

PERSONAL DEBT

The housing boom has in the short term at least been Brown's salvation. It has led to massive surges in tax receipts from Stamp Duty, Inheritance Tax, and VAT. Many people have seen their house as a kind of cash machine. Rising property values have enabled them to re-mortgage on a number of occasions, in order to fuel ever increasing personal consumption. The dramatic story of the Sub Prime mortgage collapse (mortgages made to high risk borrowers) unfolding in America seems in many ways quite detached from us, but when one considers the lax lending policies that have been in place in this country for some time now, one sees similarities which are uncomfortable. Many people are currently experiencing high levels of debt which are starting to constrict their lives. We consider it likely that the personal debt mountain that has built up will become a greater problem in the future.

PRIVATE FINANCE INITIATIVE

This is fundamentally a form of "Enron style" off Balance Sheet financing, but make no mistake it is debt and it is mortgaging the future of this country and its tax payers. An investment banker said to us recently that he loved being involved with private finance deals, because there was so much money to be made, but that as a taxpayer they made him want to weep. He knew the full inside story of how much the taxpayer was going to have to pay over a period of time and this story is yet to unwind in the future. All government borrowing is effectively deferred taxation and the UK taxpayer will eventually have to pay the PFI liabilities.

TAX CREDITS

This was entirely Brown's idea and it is a hopelessly over complex, expensive to administer disaster. In excess of £2billion a year is being overpaid and the waste of resources running this system is unbelievable. The full extent of this disaster is probably already in the public domain, but it is worth pointing out that the doubling of the 10% starting rate of Income Tax has a knock on effect on Tax Credits, meaning that even more people will become dependent on them. People trying to claw their way up the ladder and therefore becoming less dependent on Tax Credits will find they are faced with a marginal tax rate of over 70%. Lunacy!

REGULATION AND RED TAPE

KPMG, a leading firm of accountants, were paid £5million to research red tape. They phoned around a few businesses and came to the conclusion that the total administrative burden placed on business by the UK tax system is approximately £5.1billion a year, which equates to 1.1% of the total tax take. The last 10 years has seen a tidal wave of regulation emanating from all areas of government. Much of this regulation originates in Brussels and our elected leaders seem to take great delight in gold plating it and imposing it on us mere subjects. Many of our clients will be aware of the new Construction Industry Scheme, which comes into effect from the 6th April 2007. Under the new scheme, contractors will have to make 12 monthly Returns instead of one annual Return. The procedures on establishing under what basis sub-contractors can be paid by them (gross or at what level of tax deduction) have been made significantly more burdensome. We were therefore flabbergasted to see that HM Revenue & Customs estimates that the new CIS has already saved £55million! To be honest, this looks like a sick joke.

As with all regulation, the impacts are felt hardest by small businesses. In our opinion, much of the additional regulation is poorly policed, so that the burdens felt by those who comply are disproportionately greater than those who fail to comply and who suffer no penalty.

CONCLUSION

If the media are to be believed, we now await the Brown Premiership. We fail to see how a control freak can be a successful Prime Minister. Brown's habit of disappearing when there is bad news will not be a practicable policy for him if he does indeed reach No. 10. We also believe that Mr Brown's Scottish credentials might finally lead the comatose English to question their lack of democratic power. Scottish members of the UK Parliament can legislate for England in every possible area of law and government. No English MP can participate in the making of any legislation in matters reserved to the Scottish Parliament. It seems unlikely that this imbalance can continue indefinitely and with the dour Scot at No. 10, we would be surprised if this matter does not attract more attention.