BUDGET NEWSLETTER 2008

Alistair Darling delivered his first Budget in March and we have now had a chance to sift through the small print and assess the likely impact on our clients. In line with his predecessor, Mr Darling spent a great deal of his (sleep inducing) 51 minute speech announcing once again previously announced ***good*** news, whilst conveniently ignoring less pleasant matters. When the reckoning is done however, the plain facts will be obvious to all. Government borrowing is going up and so are taxes.

Some of the key points that clients should be aware of are as follows:

TAX RATES

- For 2008/09 the basic rate of income tax is reduced from 22% to 20%. However the 10% starting rate of tax has been abolished (except for savings income) and this will mean that many taxpayers will see little or no benefit from the tax 'cut'.

- The revised personal allowance of £5,435 will mean the higher rate tax threshold (40%) will rise to £41,435. We consider the personal allowance to be desultory when you take account of the very high cost of living in this country. The threshold at which higher rate tax becomes payable is also absurdly low and Labour has refused to increase the threshold in line with increases in earnings. As a result, the number of people paying the top rate of tax has more than doubled since 1997.

- The National Insurance upper threshold has increased significantly. This will hit middle and higher earners because they will pay 11% on weekly earnings between £670 and £770, rather than the 1% that applied previously.

  The National Insurance hike will also impact on the self employed. The Class 4 National Insurance liability on self employed profits of £40,000 will jump by £340 for the 08/09 year.

VAT

- The VAT registration threshold has been raised to £67,000 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.

SAVINGS

- As we advised last year, the annual ISA savings limit will be raised from £7,000 to £7,200, a paltry increase of under 3% for the 8 years that the ISA regime has been running. The distinction between maxi and mini ISAs will be abolished, to be replaced by cash ISAs and stocks-and-shares ISAs. The full £7,200 limit will apply to the latter, with the cash ISA limit totalling £3,600.

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TAX RELIEF ON PENSION CONTRIBUTIONS

- We were delighted that no change was announced to the rate of tax relief available on pension contributions. A number of commentators felt this valuable relief, which costs the Treasury as much as £17 billion per annum, might be curtailed in some way. Basic rate tax relief will continue to be available to all (subject to certain thresholds) and higher rate relief will continue to be available to those subject to 40% tax. This means that for a higher rate taxpayer, the net cost of making an investment in their pension fund of £100 is just £60.

  We believe that anyone paying higher rate tax should consider this option carefully. It remains a distinct possibility that this relief may be reduced in years to come.

NEW CAPITAL ALLOWANCE REGIME

- The Chancellor confirmed that a new annual investment allowance (AIA) would come into force for the 08/09 year. The first £50,000 of expenditure on most plant and machinery will attract 100% tax relief. This means that qualifying expenditure up to £50,000 will result in a corresponding reduction in the taxable profits. Previously, relief was given at 50% during year one and then at a rate of 25% on a reducing balance basis in subsequent years.

  It is worth noting that expenditure on cars will NOT qualify for this relief, although expenditure on commercial vehicles (vans, double cab pick-ups etc) will qualify.

  - It will be possible to write off pools of unrelieved capital expenditure held at the start of the 08/09 tax year of up to £1000 in one go.

  - The capital allowance regime for cars used for business purposes will also change significantly from the **09/10** tax year. From 06/04/09 onwards the capital allowances available will be dependent on the CO2 emissions figure of the vehicle. In line with Government policy, higher emitting cars will be disadvantaged.

INCOME SHIFTING

- In December 2007, the Chancellor announced that he would bring in legislation, effective from the 08/09 tax year, to tackle what the Government perceived to be the problem of Income Shifting.

- Income Shifting is a term coined by the Treasury with the objective of getting countless family businesses (limited companies and partnerships) to pay more tax. The Inland Revenue had previously lost a 6 year Court battle in the case Arctic Systems when the Law Lords ruled (quite correctly) against them. As a result, the Treasury determined they would change the law to penalise these small businesses.

- The Income Shifting proposals stated that where income/profits were divided between a husband and wife, it would be necessary to be able to prove that the allocation was clearly in line with the value added to the business by each partner. Records would need to be kept to substantiate the allocation.

- The proposals were utterly absurd in almost every respect. They completely ignored the reality of most family run businesses, where it is clearly not possible to quantify the input of each partner in the way suggested by the Treasury by looking at the value of the service provided on the 'open market'.

- Business groups and accountants complained to the Treasury and the good news is that the preposterous proposals will NOT come into force for the 08/09 year. The bad news is that the plans are deferred to allow further consultation.

- Mr Darling did not have the guts to mention the deferral in his speech. Instead, he chose to bury the biggest move for small businesses in his Budget, in the paperwork issued to tax advisors.

CAPITAL GAINS TAX

- Significant changes have been made to the CGT regime. Indexation (an allowance for inflation) and taper relief which replaced it in 1998, have both been abolished. The tax rate applied to the capital gain will no longer be calculated by treating the gain as the top slice of taxable income and applying the appropriate tax rate.

- Instead, a flat rate of 18% will be used to calculate the CGT liability. For many people who hold business assets, this represents an 80% tax increase. The abolition of indexation relief will put up many people's CGT liabilities by significantly more than this figure.

- There will also be some 'winners' under the new regime, such as people who have held property for a short time and have made a significant gain. After intense lobbying, the Chancellor did introduce a relief called Entrepreneurs' Relief which will reduce the effective tax rate to 10% for certain business disposals.

- Because of the complexity of the rules, any client who anticipates making a capital gain should contact us to discuss their circumstances.

INHERITANCE TAX

- Comrade Brown was forced to soften the impact of this tax after the Conservatives proposed a £1 million IHT exempt band. Laughably, he tried to claim his revisions had nothing to do with the Tory proposals. Under the new IHT regime, any unused IHT nil rate band arising on the death of the first spouse (£312,000 for 08/09) will be transferable. This will mean that a combined estate of up to £624,000 could escape any IHT.

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- Clients who have previously set up arrangements whereby half their house is left to their children or other beneficiaries on the first death of a couple, will need to consult their solicitors about this change. It is quite possible that these arrangements could now be **disadvantageous** under the revised regime.

OUR VIEW

Gordon Brown has told us so many times what a miraculous economy we have. Sixty consecutive quarters of growth, employment at record levels, low interest rates, the abolition of boom and bust. The disingenuous bluster didn't stop there. We have been bombarded with 'statistics' and 'facts' confirming how wonderful everything is in relation to education, health, crime, inflation, taxation, child poverty, public finances etc.

The biggest lies were saved for the biggest issues. Referendum on the European Constitution anyone? No, no need to worry about that. Weapons of mass destruction? Perhaps not. Debate about the merits of unchecked mass immigration and multiculturalism? Don't think we'll bother with that one. Democratic deficit of the English? They'll never notice the money heading towards Brown's homeland. Change the way inflation is measured? Don't worry, they're all too busy remortgaging to worry about that.

Lenin observed that a lie repeated often enough becomes the truth. The politicians occupying the bizarre world of Planet Brown clearly believe this.

So how have they got away with this for so long? No effective opposition, a compliant press and the deliberate dumbing down of education all contributed. But perhaps the greatest contributory factor of all, was that the general public were too busy indulging in the biggest credit fuelled consumer boom in history to worry too much. Consumer debt in the UK totalled £1.4 trillion at the last count (and unsecured debt is still rising). Added to that, the Government is set to borrow £140 billion over the next four years to make ends meet. It appears they forgot to put any money aside during the 'boom' years, as they were too busy hiring public sector workers, pouring vast amounts of money into an unreformed NHS and handing out welfare cheques to the 5 million non-workers in the UK.

The day of reckoning is now here of course. The unsustainable house price boom is over, the 'cheap' mortgage deals are evaporating on a daily basis and the nationalised Northern Wreck is further bleeding the tax coffers. Brown and Darling weakly try to tell us that we are well placed to weather the storm. Quite how a nation with such a huge personal debt mountain and record tax levels is well placed to ride out the global credit crunch is beyond us.

We feel that clients need to carefully consider their personal circumstances. The era of cheap credit is over for the foreseeable future. Many people are likely to experience increased financial pressure as the burdens of higher taxes and living costs take effect.

As always, we will do everything possible to assist clients in the more difficult times to come. Please do not hesitate to contact us to discuss your personal circumstances.