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2006 Budget Report

By Carl Bayley BSc ACA

NUMBER TEN FOR GORDON

*By Carl Bayley BSc ACA
Senior Consultant, Taxcafe.co.uk*

On 22nd March 2006, Gordon Brown finally made it to number ten. Ten Budget Statements that is!

The Chancellor himself reminded us of this fact right at the beginning of his speech to a packed House of Commons and a nationwide television audience of millions. He pointed out that he was the first Chancellor since 1822 to reach the landmark of a tenth consecutive Budget Statement.

The Chancellor's Georgian predecessor had achieved his longevity in the post on the back of a promise to abolish Income Tax. Sadly, our current Chancellor swiftly confirmed that this was most definitely not on the cards!

Mr Brown also pointed out that the last Chancellor to achieve a decade in the post had gone on to another important Government post – Chancellor of the Duchy of Lancaster.

Turning to more recent history, we see that, out of the 33 Chancellors of the Exchequer appointed since 1900, only nine have gone on to become Prime Minister. Statistically, that gives our Gordon a mere 27% chance of succeeding in his well-publicised ambition to take over the top spot in UK Government.

History, however, does not seem to bother the 'Iron Chancellor' and his Budget Number Ten was a clear bid for his anticipated move into another Number Ten as he spent the next hour setting out his manifesto for the next decade to the apparent bemusement of his present next-door neighbour seated on the bench just behind him.

Which brings us to tax, or at least it should! I have become accustomed to the Chancellor's Budget Statement providing only the 'tip of the iceberg' when it comes to the changes being made to the UK tax regime but, this year, the tax content in his speech was almost non-existent. In a speech of sixty-one minutes duration, taxation seemed to take up no more than three minutes or so.

So, where was the tax? Has the Chancellor run out of ideas? Perhaps, yes, but he and his colleagues have done enough 'tinkering' to provide over 200 pages of Budget Notes, News Releases and Press Notices covering subjects as diverse as Bus Travel, the Olympics, Contraceptives, Microgeneration Technology and Gross Gaming Yields. [It may not quite be lion-taming, but accountancy is not as boring as Monty Python would have you believe.]

What follows is the most useful part of what I have been able to glean from amongst all of this diverse trivia.

INCOME TAX & NATIONAL INSURANCE

For most taxpayers, there was no significant change to their Income Tax position. The personal allowance and the lower and basic rate tax bands will all increase roughly in line with retail price inflation (confirmed as 2% in the Budget speech), and will be as follows for 2006/2007:

- Personal allowance increases from £4,895 to £5,035
- Lower rate band increases from £2,090 to £2,150
- Basic rate band increases to give a new higher rate tax threshold of £33,300, (increased from £32,400 for 2005/2006)

The upper and lower limits for National Insurance Contributions also increase in line with retail inflation.

Employed Earners

The combined annual Income Tax and National Insurance burden for employed earners therefore decreases slightly (in most cases) as follows:

Annual Earnings	Tax & NI 2005/2006	Tax & NI 2006/2007	Decrease
	£	£	£
£10,000	£1,434	£1,380	£54
£20,000	£4,734	£4,680	£54
£30,000	£8,034	£7,980	£54
£40,000	£11,097	£10,934	£163
£50,000	£15,197	£15,034	£163
£50,000+	+ 41% of excess		

Not everyone is better off however. As in previous years, the interaction between the National Insurance and Income Tax bands creates a band of taxpayers who will actually see a small increase in their tax burden. This time it is those earning between £33,295 and £37,431 who will be worse off. The worst hit are those with earnings between £33,540 and £37,295, whose total tax bill increases by £25.

This band of unfortunates are earning only slightly more than the national average for a full-time male employee, £30,600. Interestingly enough, despite being only just above average, the £35,000 income level does not appear on the Government's published year-on-year comparative tables. (The phrase 'lies, damn lies and statistics' springs to mind!)

You might be forgiven for thinking that a Labour Government can't be expected to favour those with above average earnings. Perhaps not, but it is interesting to note that within their own statistics we see that, when we also take Tax Credits and Child Benefit into account, a couple with one child, both working full-time on the national minimum wage (£5.35 per hour from October 2006) will actually be £83 worse off in 2006/2007.

Contrast this with a similar couple with household income of £100,000, who will be £350 better off next year and the social philosophy behind the tax changes begins to seem questionable!

Employers

The increase in the lower National Insurance Contribution threshold (in line with the personal allowance) will save employers £17.92 per year per employee (well, most employees anyway), although they will continue to pay 12.8% on all wages and salaries over £97 per week.

Self-Employed Earners

We get slightly different figures for the self-employed, as follows:

Annual Earnings	Tax & NI 2005/2006	Tax & NI 2006/2007	Decrease
	£	£	£
£10,000	£1,390	£1,341	£49
£20,000	£4,390	£4,341	£49
£30,000	£7,390	£7,341	£49
£40,000	£10,370	£10,188	£182
£50,000	£14,470	£14,288	£182
£50,000+	+ 41% of excess		

Once again, there is a group of taxpayers who will find themselves slightly worse off. Those with self-employment or partnership trading income of between £33,540 and £37,295 will have to find an extra £5.40 this year.

Landlords

For those whose income is derived solely from rental income, the increased tax bands give rise to the following tax savings for 2006/2007:

Annual Earnings	Tax & NI 2005/2006	Tax & NI 2006/2007	Decrease
	£	£	£
£10,000	£872	£834	£38
£20,000	£3,072	£3,034	£38
£30,000	£5,272	£5,234	£38
£40,000	£7,959	£7,734	£225
£50,000	£11,959	£11,734	£225
£50,000+	+ 40% of excess		

Since landlords continue to be exempt from any class of National Insurance Contributions, they will again benefit from the greatest potential tax savings. Furthermore, there is no band of landlord taxpayers suffering any tax increase!

Families & Tax Credits

The biggest news here is the *ten-fold* increase in the 'income disregard' from £2,500 to £25,000. The 'income disregard' represents the amount by which a tax credit claimant's income can increase over the previous year before this increase starts to trigger a repayment of overpaid tax credits.

Rather than an act of generosity, this dramatic increase is really an admission of the terrible disarray in which the tax credits system now finds itself, with the Revenue having been forced to give up the pursuit of repayments of millions of pounds in tax credits overpaid to families who simply cannot afford to give them back.

The mind boggles with the tax planning potential of this newly increased exemption, but I suspect it may prove short-lived!

Other key features of this year's changes to the tax credit system include:

- All of the elements of the Working Tax Credit increase roughly in line with inflation. Total increases could reach a maximum of £1,765 in some cases.
- The proportion of eligible childcare costs which may be claimed for tax credit purposes increases from 70% to 80%. This provides a maximum potential increase of £30 per week.
- The child element of Child Tax Credit is to increase by £75 to £1,765.

Surprisingly, there is no increase to the 'baby tax credit' this year, despite the fact that another addition to the Brown family is anticipated in the summer. The new arrival will, however, be entitled to payments of £250 into its Child Trust Fund both at birth and on its seventh birthday. Had the Browns been a 'lower income family', these payments would have been increased to £500 each.

Pensioners

Key changes for pensioners included:

- The personal allowance for those aged 65 to 74 increases from £7,090 to £7,280.
- For the over 75's, the increase is from £7,220 to £7,420.
- Married couples and civil partnerships including one spouse or partner born before 6th April 1935 also continue to receive a 'Married Couple's Allowance' of between £2,350 and £6,135.
- Free national off-peak bus travel throughout England & Wales for all over 60's from April 2008.

BUSINESS

Corporation Tax

Here's a bit more history for you.

In the year 2000 our Chancellor introduced a 'starting rate' of 10% Corporation Tax on the first £10,000 per annum of a company's profits.

In 2002, the starting rate was reduced to Nil – some dubbed this a 'personal allowance for companies'. Many of us predicted a rush of business incorporations but worried what the future might have in store.

In 2004, claiming to be surprised at the number of companies being formed purely for tax purposes, the Chancellor introduced the 'non-corporate dividend rate' as a penalty for small companies paying out low- or non-taxed profits as dividends. The complexities of this new charge proceeded to drive us all mad and I, for one, dubbed the Chancellor a 'child-catcher' (as in Chitty Chitty Bang Bang) for having encouraged taxpayers to form companies with the promise of low taxation and then 'slammed the door' on thousands of businesses which had fallen into this trap.

Now, in 2006, we get the abolition of both the starting rate and the non-corporate dividend rate. The trap is now complete!

So, was it all just a big mistake from a naïve Government who only wanted to encourage business growth and never expected it to be used for tax avoidance purposes? Or was it a devious plan to entice more business into the more visible and highly regulated corporate arena? I have my own view, but you must make up your own mind on this one.

First Year Allowances

By way of a tiny compensation for this dramatic about-turn, the 50% first year allowance on new plant and machinery purchased by small businesses is to be reinstated (again) for one year from 6th (1st for companies) April 2006 to 5th April 2007 (31st March for companies).

This same one-year increase in the allowance also applied for 2004/2005 and we might perhaps therefore now dub it the 'yo-yo allowance'.

A small business for this purpose is generally one with an annual turnover of not more than £5,600,000.

VAT

The registration and de-registration thresholds increase to £61,000 and £59,000 respectively from 1st April 2006.

Computers & Mobile Phones

The exemption from benefit-in-kind charges on loans of computers to employees for private use will cease on 6th April 2006.

From the same date, the exemption for the provision of mobile phones to employees will be restricted to one phone per employee.

Compliance – Online Filing

The Government has a stated aim of improving e-commerce in the UK. As part of this strategy, they are trying to encourage online filing of various tax returns, etc. The fact that the online filing system for Income Tax Self-Assessment suffered a disastrous crash in January 2005 did not help their cause here.

They've tried the 'carrot' (in the shape of incentive payments for online filing of employer's year end returns), now here comes the 'stick'.

The latest proposals are that, from 2008, the Income Tax Self-Assessment deadline will be brought forward by four months to 30th September for paper returns. Returns filed online, however, will have a more relaxed deadline of 30th November. In practical terms this means that all accountancy firms and many individuals will be forced to file online or face a penalty of £100 per return.

But there's more!

The online filing campaign also extends to VAT returns and all Revenue forms requiring completion by employers. The proposed introduction of compulsory online filing is as follows:

2008: Large and medium-sized VAT traders and employers and all newly registered VAT traders.

2010: All companies and most of the remaining VAT traders and employers.

2012: Very small self-employed businesses.

Personally, I've always found the carrot to be more effective than the stick, but we shall see what happens.

PROPERTY

Once again, the deeper recesses of the Budget reveal a raft of changes affecting the property sector.

Real Estate Investment Trusts

First and foremost, the Chancellor has finally made up his mind on the format to be adopted for the new Real Estate Investment Trusts ("REITs") which are to come into being on 1st January 2007. The key features include:

- Rental income and capital gains derived from investment properties will be exempt from tax within the REIT.
- Dividends paid out by the REIT will be treated as property income (i.e. like rent) in the hands of the investor. [This means tax payable of 22% for basic rate taxpayers receiving the dividends, instead of 0%; and 40% for higher rate taxpayers, instead of an effective 25%.]
- At least 90% of the REIT's tax exempt profits must be paid out as dividends each year.
- The REIT must be UK Resident and listed on a recognised stock exchange.
- No single investor may hold 10% or more of the REIT's shares.
- At least 75% of the REIT's assets must be investment property.
- At least 75% of the REIT's income must be rental income.
- The REIT's ratio of interest payable to rental income must be less than 1.25:1

Existing companies which qualify as set out above and which wish to convert to REIT status can do so on payment of an entry charge equal to 2% of the market value of the company's investment properties. This charge can be spread over four years on 'generous payment terms' (i.e. it will cost you!).

Stamp Duty Land Tax

The Budget contained a number of Stamp Duty Land Tax provisions, including:

- The Stamp Duty Land Tax threshold for residential property increases from £120,000 to £125,000 with effect from 23rd March 2006, providing savings of up to £1,250 (albeit in rather limited circumstances).
- Exemptions for alternative finance arrangements (e.g. Shari'a compliant finance) which previously applied to individuals only are extended to all persons (e.g. companies, partnerships, etc).
- New Stamp Duty Land Tax exemptions are introduced for gifts of property where the donee assumes responsibility for Capital Gains Tax or Inheritance Tax.
- There will no longer be a Stamp Duty Land Tax charge on the payment by a tenant of their landlord's costs on the grant, variation or termination of a lease.
- From Royal Assent to the 2006 Finance Act (probably around July), the transfer of interests in a partnership which owns property will be exempt from Stamp Duty Land Tax where the partnership's main activity is a trade or profession, other than a trade of dealing in, or developing, land.
- A previous exemption for transfers of property to a Unit Trust in exchange for units is abolished.

Other Property Tax Issues

The Landlord's Energy Saving Allowance is extended to include draught proofing and insulation for hot water systems. The allowance provides immediate tax relief for energy saving expenditure of up to £1,500 per building per tax year.

As already announced in December 2005, it was confirmed that self-directed pension schemes will be unable to invest in residential property.

Registered Social Landlords holding service charges in Trust will be exempt from the higher trust rate (40%) on Trust income and will pay the standard rate (usually 20%) instead.

CARS & FUEL

As usual, the Budget includes a large number of changes affecting the motorist, including:

- A further tightening of the CO2 emissions limits applying to company cars will mean a further 1% increase in the charge applied to most company cars from 6th April 2008. (E.g. if your income tax benefit in kind charge is currently based on 27% of your car's purchase price, this will rise to 28% from April 2008.)
- Also from 6th April 2008, a new 10% band will be applied to cars with exceptionally low CO2 emission levels.
- The duty on fuel is to be increased by 1.25p per litre from 1st September 2006. (So, for the third year running, remember to fill up on 31st August!)
- From 1st April 2006, Road Tax (aka Vehicle Excise Duty) will be reduced for more environmentally friendly cars but increased for those with higher carbon emissions. The worst culprits face a £45 increase to £210. According to the Chancellor "the Duty on 50% of vehicles will be frozen or reduced". It doesn't take a maths degree to realise this means that the Duty on 50% of vehicles will be increased.
- The VAT scale charges for provision of private fuel all increase at a cost of between around £14 and £30 per annum.

TRUSTS AND INHERITANCE TAX

The nil rate band threshold for Inheritance Tax was already set to increase from £275,000 this year to £285,000 for 2006/2007 and £300,000 for 2007/2008. Further increases to £312,000 in 2008/2009 and £325,000 in 2009/2010 were announced in the Budget. Last year I said "Helps a bit, but much more is needed". Ditto!

New legislation announced in the Budget will, as expected, block the potential Inheritance Tax advantages of 'Alternatively Secured Pension' arrangements under the new pensions regime coming into force on 6th April 2006.

Trusts get a major shake-up with some significant restrictions on Inheritance Tax reliefs previously available to 'Interest in Possession Trusts' and 'Accumulation and Maintenance Trusts'. The changes to Interest in Possession Trusts are, however, a double-edged sword and create new planning opportunities as well as closing off some old ones!

The standard rate tax band for Trusts increases from £500 to £1,000 with effect from 6th April 2006.

Trusts will be treated as 'settlor interested' (so that income and gains are taxed directly on the settlor) in most cases where a dependent minor child of the settlor is a beneficiary of the Trust.

The Income Tax and Capital Gains Tax treatment of Trusts, in particular the tests to determine whether they are UK Resident for tax purposes, are to be harmonised.

VENTURE CAPITAL

A number of alterations were made to the three existing venture capital regimes: Venture Capital Trusts, the Enterprise Investment Scheme and the Corporate Venturing Scheme.

- Income Tax relief for investment in Venture Capital Trusts will reduce from 40% to 30% with effect from 6th April 2006.
- The minimum holding period to qualify for relief on investment in Venture Capital Trusts is extended from three years to five.
- The limit for Enterprise Investment Scheme investments to attract Income Tax relief at 20% and possibly also Capital Gains Tax hold over relief (worth up to 40%) is doubled from £200,000 to £400,000 per person per tax year. Up to half of an investment of up to £100,000 made before 6th October can also be carried back for relief in the previous tax year.
- The size of companies eligible as investments under all three of the venture capital regimes is dramatically reduced to a limit of gross assets of no more than £7,000,000 before the new investment and £8,000,000 after the investment (down from £15,000,000 and £16,000,000 respectively).

DISCLOSURE & ANTI-AVOIDANCE

The rules requiring the promoters of tax avoidance schemes to disclose these to Revenue and Customs were extended to any schemes which seek to avoid Income Tax, Corporation Tax or Capital Gains Tax.

Many new anti-avoidance measures were introduced to target existing avoidance schemes, most of which have come to the Revenue's attention under the disclosure rules.

In particular, schemes to avoid Income Tax and National Insurance through the granting of share options to employees were blocked and this was backdated to 2nd December 2004. If that's not retrospection, I don't know what is!

THE BEST OF THE REST

Finally, here's a quick round up of some of the other changes:

- The Capital Gains Tax annual exemption increases by £300 to £8,800 for 2006/2007.
- Beer goes up 1p a pint.
- Wine goes up 4p a bottle.
- Fags up 9p a packet.
- Minimum Wage increases to £5.35 per hour from October 2006.
- Landfill Tax increases from £18 to £21 per Tonne (for 'active' waste).

- Changes to company group relief rules will allow the set-off of losses made by foreign subsidiary companies within the European Economic Area against taxable UK profits where these losses cannot be used elsewhere. (This follows the result of the 'Marks and Spencer' case which the Revenue lost recently.)
- Overseas sportsmen and women, organisers and officials will be exempt from UK tax on income derived from the 2012 Olympics.
- The new pensions regime commences on 6th April 2006 with an annual allowance of £215,000 and a lifetime allowance of £1,500,000 governing the maximum contributions eligible for tax relief.



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