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# 2008 Budget Report

*By Carl Bayley BSc ACA*

# All Change?

(Budget 2008 Analysis)

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

Last October, new Chancellor of the Exchequer, Alistair Darling, arrived on the scene with quite a bang when he made several surprise announcements in his Pre-Budget Report. Business groups and other interested parties were shocked at the Chancellor's sudden decision to make huge fundamental changes to many areas of the UK tax system.

Since then, many groups have lobbied the Chancellor to reform or postpone his most radical proposals. A little ground was given but, in general, HMS Darling seemed determined to steam ahead regardless.

So, still reeling from the shock of last October's extraordinary events and bearing in mind this Government's amazing track record for last-minute U-turns, we waited for the new Chancellor's first Budget Statement with some trepidation. What would he do this time; were we in store for more shock announcements?

After his rather dramatic start in the job last year, new boy Darling's first Budget Statement delivered on 12<sup>th</sup> March 2008 was quite an anti-climax: well under an hour in length, very short on substance and absolutely no shock announcements. And what he lacked in substance he totally failed to make up for in style. As I've heard it said, 'Deadpan delivery comes very naturally to Mr Darling'.

As usual, however, the Budget Statement delivered to the House of Commons covered just a tiny fraction of the many proposals contained in more than 300 pages of press notices and budget notes issued as soon as the Chancellor sat down.

Having read through more than 100 notes published by HM Revenue and Customs, I can confirm that HMS Darling is definitely still steaming ahead with those shock announcements from his Pre-Budget Report. Is he convinced that he is right or is he afraid to admit that he is wrong?

Confirmation was, in fact, very much the theme of this Budget: confirming most of the changes proposed by Gordon Brown in the last Budget and by

the Chancellor himself last October. You might say that there's no change to the strategy of 'all change'.

### **What We Already Knew**

At this point, it is worth recapping some of the main changes we already knew about and which were confirmed in the Budget:

- The basic rate of Income Tax reduces from 22% to 20% from 6<sup>th</sup> April 2008
- The 10% starting rate of Income Tax is abolished except in respect of savings income
- Age-related personal allowances for the over 65s increase substantially
- The upper earnings limit for National Insurance is increased significantly as part of a process to bring it into line with the point at which higher rate Income Tax applies from 6<sup>th</sup> April 2009
- The rate of Tax Credit withdrawal (except for the family element of £545) increases from 37% to 39% from 6<sup>th</sup> April 2008
- The first income threshold at which Working Tax Credit begins to be withdrawn is to be increased from £5,220 to £6,420 from 6<sup>th</sup> April 2008
- A new single flat rate of Capital Gains Tax at 18% is to apply from 6<sup>th</sup> April 2008
- Taper relief and indexation relief for Capital Gains Tax are abolished from 6<sup>th</sup> April 2008
- Widows, widowers and surviving civil partners alive on 9<sup>th</sup> October 2007 are entitled to any unused proportion of their deceased spouse's Inheritance Tax nil rate band
- Corporation Tax for large companies falls to 28% from 1<sup>st</sup> April 2008
- Corporation Tax for small companies increases to 21% from 1<sup>st</sup> April 2008 and again to 22% from 1<sup>st</sup> April 2009
- The capital allowances regime is to undergo major reform from April 2008
- Non-domiciled individuals resident in the UK for over seven years will be hit with a £30,000 annual charge if they continue to claim exemption from UK tax on unremitted foreign income and gains
- Persons claiming the remittance basis of taxation will lose entitlement to personal allowances and the annual Capital Gains Tax exemption

(Full details of the new tax rates and allowances applying from 6<sup>th</sup> April 2008 are set out in the Appendix.)

So, if we already knew about all of these major changes, what was left in the Budget?

In essence, whilst there are a few new items worthy of note, the vast majority of this year's Budget proposals simply amount to the confirmation and refinement of the changes we already knew about. Still, as they say, 'the Devil is in the detail'!

## **Employment Income**

Last year, (following a rather more exciting Budget), I produced a forecast of the likely rates of combined Income Tax and National Insurance on employment income received by individuals under retirement age over the next few years.

Given the anticipated alignment of the higher rate Income Tax threshold with the upper earnings limit for National Insurance from 6<sup>th</sup> April 2009, it's worth revisiting that forecast in the light of the latest proposals:

	2008/9			2009/10			2010/11		
	%	Band	Cum	%	Band	Cum	%	Band	Cum
Personal Allowance	0%	£5,435	£5,435	0%	£5,635	£5,635	0%	£5,835	£5,835
Basic rate band	31%	£34,605	£40,040	31%	£38,100	£43,735	31%	£39,500	£45,335
Basic rate band	21%	£1,395	£41,435	n/a			n/a		
Higher rate	41%	thereafter		41%	thereafter		41%	thereafter	

### **Notes to the table**

1. 'Cum' = cumulative income for allowances and bands up to that point.
2. The first part of the basic rate band in 2008/9 is subject to both Income Tax and National Insurance at 11%.
3. The second part of the basic rate band in 2008/9 is subject to Income Tax plus National Insurance at just 1%.
4. Higher rate income suffers Income Tax at 40% plus National Insurance at 1%.
5. The allowances and tax bands quoted above for 2008/9 are accurate. Those quoted for 2009/10 and 2010/11 are projections based on the changes we are aware of combined with an estimated inflation rate.

## What Will These Changes Do To Your Tax Bill?

Based on the previous table, the combined annual Income Tax and National Insurance burden on employment income is as follows:

Annual Earnings	Tax & NI	Tax & NI	Tax & NI	Tax & NI
	2007/8	2008/9	2009/10	2010/11
£10,000	£1,308	£1,415	£1,353	£1,291
£20,000	£4,608	£4,515	£4,453	£4,391
£30,000	£7,908	£7,615	£7,553	£7,491
£40,000	£10,724	£10,715	£10,653	£10,591
£50,000	£14,824	£14,618	£14,442	£14,204
£50,000+	+ 41% of excess in each year			

(The first two years' figures are actual. Those for the second two years are forecasts. This also applies to the next three tables below.)

Comparing 2008/9 with 2007/8, we can see that the loss of the starting rate band leaves those with lower incomes considerably worse off. Many employed earners on low incomes will, however, receive more Tax Credits in 2008/9. A single person earning £10,000, for example, will receive an additional £372 in Tax Credits leaving them £265 better off overall.

Where the employee is earning the second wage in the household, however, the tax increases may not be offset by Tax Credit increases and, in the worst case, someone with a salary of £7,455 could be as much as £158 worse off in 2008/9 (a lot of money to them).

Those with moderate income are a little better off (but perhaps not in real terms when you take inflation into account).

Those with a salary of £40,000 make a saving of just £9. This is due to the large increase in the upper earnings limit for National Insurance meaning that these people have to pay National Insurance at 11% on over £5,000 more of their salary than in 2007/8.

In fact, there is a small band of salary level from £39,721 to £39,906 for which employed earners will be slightly worse off in 2008/9, with the worst affected on a salary of £39,825 **losing** £9.

## Self-Employed Earners

The self-employed pay National Insurance at the main rate at 8% instead of 11%, so we get slightly different figures, as follows:

<b>Annual Earnings</b>	<b>Tax &amp; NI 2007/8</b>	<b>Tax &amp; NI 2008/9</b>	<b>Tax &amp; NI 2009/10</b>	<b>Tax &amp; NI 2010/11</b>
£10,000	£1,165	£1,278	£1,222	£1,166
£20,000	£4,165	£4,078	£4,022	£3,966
£30,000	£7,165	£6,878	£6,822	£6,766
£40,000	£9,835	£9,678	£9,622	£9,566
£50,000	£13,935	£13,580	£13,299	£13,019
£50,000+	+ 41% of excess in each year			

In addition to the above taxes, most self-employed earners also have to pay Class 2 National Insurance, which is increasing from £2.20 to £2.30 per week from 6<sup>th</sup> April 2008.

## Landlords

For those whose income is derived solely from rental income, the tax burden over the next few years will be as follows:

<b>Rental Profits</b>	<b>Tax 2007/8</b>	<b>Tax 2008/9</b>	<b>Tax 2009/10</b>	<b>Tax 2010/11</b>
£10,000	£783	£913	£873	£833
£20,000	£2,983	£2,913	£2,873	£2,833
£30,000	£5,183	£4,913	£4,873	£4,833
£40,000	£7,414	£6,913	£6,873	£6,833
£50,000	£11,414	£10,626	£10,126	£9,766
£50,000+	+ 40% of excess in each year			

The burden here is lower due to the fact that National Insurance is not due on rental income.

## Pension Income

Pension income received by a person aged under 65 at the end of the tax year will suffer the same rates of tax as rental income in the previous table.

As explained above, persons aged over 65 are benefitting from significant increases in personal allowances for 2008/9.

The tax burden on a person aged between 65 and 74, but born on or after 6<sup>th</sup> April 1935 (and not married to, or in a civil partnership with, a person born before that date) for the next few years is as follows:

<b>Pension Income</b>	<b>Tax 2007/8</b>	<b>Tax 2008/9</b>	<b>Tax 2009/10</b>	<b>Tax 2010/11</b>
£10,000	£271	£194	£130	£64
£20,000	£2,471	£2,194	£2,130	£2,064
£30,000	£5,183	£4,913	£4,870	£4,724
£40,000	£7,414	£6,913	£6,873	£6,833
£50,000	£11,414	£10,626	£10,126	£9,766
£50,000+	+ 40% of excess in each year			

## **Capital Allowances**

A large number of reforms to the system of capital allowances claimed by businesses are to take place from April 2008. Most of the changes apply to capital expenditure by companies on or after 1<sup>st</sup> April 2008 or to capital expenditure by sole traders or partnerships on or after 6<sup>th</sup> April 2008.

The main changes are as follows:

- The 50% first year allowance for qualifying expenditure by small businesses (or 40% for medium-sized businesses) will cease to apply.
- From April 2008, businesses of all sizes will be eligible for a 100% first year allowance on the first £50,000 of eligible expenditure each year. The new allowance is known as the 'annual investment allowance'.
- The annual investment allowance will be available in full to each company or unincorporated business except for companies in a group or any business entity which is 'related' to other business entities under the control of the same person or persons.
- A 'related' business entity is broadly one which shares the same business premises or which carries out similar activities. Companies and unincorporated businesses cannot be related to each other for this purpose.
- Groups of companies and related business entities will have to share a single annual investment allowance. They may allocate the allowance amongst them as they wish.
- Businesses may also allocate the annual investment allowance to whatever qualifying expenditure they wish. Some exclusions will apply, however. In particular, cars are not eligible for the allowance.
- For unrelieved balances on previous expenditure on plant and machinery and qualifying expenditure not covered by the annual

investment allowance, the rate of writing down allowance will reduce from 25% to 20%.

- A new category called the 'special rate pool' will be introduced.
- Writing down allowances will be given on assets in the 'special rate pool' at the reduced rate of 10% instead of 20%.
- Long-life assets, integral features in commercial buildings and thermal insulation expenditure on commercial buildings will all fall into the 'special rate pool'.
- The annual investment allowance will, however, be available in respect of expenditure which would otherwise fall into the 'special rate pool'.
- Transitional rates apply to writing down allowances and annual investment allowances where a business entity's accounting period straddles 1<sup>st</sup> or 6<sup>th</sup> April 2008 (as applicable).
- A 100% writing down allowance may be claimed on balances of under £1,000 in the main pool or the 'special rate pool'. This facility is not available for assets in unincorporated businesses where there is an element of private use.
- Industrial and Agricultural Buildings Allowances are being phased out progressively between 2008/9 and 2010/11.
- Enterprise Zone Allowances are to be abolished in April 2011. Balancing charges will continue to apply where buildings in Enterprise Zones are sold within seven years of the end of the period in which the allowance is first claimed.
- From 1<sup>st</sup> April 2008, loss-making companies may claim a 19% payable tax credit (i.e. money back) by surrendering enhanced capital allowances on energy efficient or environmentally beneficial plant and equipment (these allowances are given at 100% in the year of expenditure).

## **Cars and Fuel**

Many changes are being made to the taxation of cars used for business purposes, representing the usual combination of stealth tax and tax which is deemed to be socially acceptable because it is 'green'.

The Government's strategy seems to be to try to make business use of cars uneconomical. Having recently arrived at King's Cross station over an hour and a half late, following a dreadful journey involving two unscheduled changes, I have to wonder what they think the alternative is?

- From April 2009, the rate of writing down allowances on all cars owned by companies and/or used for business will be based on CO2 emissions rather than price.
- Cars with emissions of over 160g/km will fall into the 'special rate pool' and attract writing down allowances at just 10%.
- Lease payments on cars falling into this category will be subject to a 15% disallowance.
- Most other cars will fall into the main pool and attract writing down allowances at 20%. Cars already within the main pool will remain there.
- A 100% first year allowance will apply to cars with emissions no greater than 110g/km purchased between 1<sup>st</sup> April 2008 and 31<sup>st</sup> March 2013.
- Company car tax charges are to increase by 1% for all cars with emissions over 140g/km from 6<sup>th</sup> April 2008.
- The charges will increase by a further 1% for all cars with emissions over 135g/km from 6<sup>th</sup> April 2010.
- The charge on cars with emissions no greater than 120g/km will be levied at 10% from 6<sup>th</sup> April 2008 (or 13% for diesel cars).
- The fuel benefit charge will also increase in line with inflation from April 2009.
- Mileage allowances for business use of privately owned cars are to remain at current rates.
- The VAT scale charges for private use are to be increased from 1<sup>st</sup> May 2008.
- Fuel duty will go up by 2p per litre in October 2008, 1.84p per litre in April 2009 and by 0.5p more than inflation in April 2010.

## **Property Taxation**

Property authorised investment funds are to be introduced from 6<sup>th</sup> April 2008 as an open-ended investment alternative to real estate investment trusts (REITs).

Land remediation relief is to be available for expenditure on derelict land.

Stamp Duty Land Tax relief for new zero-carbon homes is extended to new flats. The flats must be new builds and not conversions, however.

Stamp Duty Land Tax on lease premiums for residential property is effectively reduced as the additional charges applying where there is also annual rent in excess of £600 are to be abolished with effect from 12<sup>th</sup> March 2008.

The additional charges continue for lease premiums on non-residential property but only where annual rent exceeds £1,000.

Sales of qualifying furnished holiday letting properties should generally qualify for the new Entrepreneur's Relief (see below).

## **Business Tax Changes**

The Chancellor continues to hammer small businesses with two outrageous proposals:

Firstly, relief is to be restricted for trading losses incurred by a taxpayer spending less than ten hours per week on average on their business. From 12<sup>th</sup> March 2008, relief is restricted to a maximum of £25,000 per annum in most cases.

Relief is also to be denied altogether where there is a tax avoidance motive present.

The second part of this proposal is perhaps not unreasonable (if administered fairly) but the first part is truly ridiculous.

As many readers will know, there are often perfectly good business reasons why a business owner might spend less than ten hour per week on their business (e.g. starting off by working part time in the business) and to deny relief for commercial losses is absolutely incredible. This is just plain wrong!

Rather bizarrely, the most non-active of all business owners: Lloyds underwriters and those who invest in film relief schemes, are exempt from these rules. Robbing the poor to feed the rich again Alistair?

It is not yet clear if this new rule will apply to losses from qualifying furnished holiday lettings.

The second proposal is to formalise the Revenue's dubious approach of treating all appropriations to and from trading stock as taking place at market value for tax purposes. This has the ridiculous result of taxing business owners on the notional profit derived from the self-supply of goods as if they had sold them to themselves at full price.

## **Entrepreneur's Relief**

As announced in January 2008, sales of qualifying businesses, interests in qualifying businesses and qualifying shares and securities will qualify for an effective reduced rate of Capital Gains Tax at 10%.

This relief applies to the first £1 million of qualifying gains arising on or after 6<sup>th</sup> April 2008.

The relief extends to held over gains crystallising on disposal of qualifying corporate bonds, Enterprise Investment Scheme shares and Venture Capital Trusts where the original held over gain would have qualified for the relief if it had then existed.

The relief will operate by exempting four ninths of any qualifying capital gains arising on or after 6<sup>th</sup> April 2008. Each individual will be entitled to a cumulative maximum of £1m of total qualifying gains for the purposes of this relief.

## **Other Changes In Brief:**

- The VAT registration threshold increases from £64,000 to £67,000.
- The Capital Gains Tax annual exemption increases from £9,200 to £9,600.
- The annual investment limit for income tax relief on Enterprise Investment Scheme shares is to increase from £400,000 to £500,000 subject to EU approval.
- The Government may bring in a charge on carrier bags if retailers do not act first!
- Charities may continue to reclaim tax on Gift Aid donations at the former 22% rate for a period of three years. This does not change the donor's tax position and effectively means that a higher rate taxpayer donor and the charity together will receive 42% relief in total.
- Non-domiciled or non-ordinarily resident individuals may continue to claim the remittance basis of taxation where their unremitted foreign income or gains are less than £2,000 without being subject to the new £30,000 charge or any loss of allowances.
- A new tax penalty regime is to be introduced from 2009.
- The 10% dividend tax credit currently applying to UK dividends is to apply to foreign dividends also from 6<sup>th</sup> April 2008. The credit is to be withdrawn, however, if the recipient owns 10% or more of the paying company's shares. Previous proposals to deny the credit where the

recipient receives foreign dividends totalling more than £5,000 in the year have been dropped.

- From 6<sup>th</sup> April 2009, the credit will be further extended to recipients owning 10% or more of the paying company's shares when the company pays local Corporation Tax in its home country.
- The annual investment limits for Individual Savings Accounts ('ISA's') will increase to £3,600 for cash and £7,200 for shares and securities (also the overall limit) from 6<sup>th</sup> April 2008.
- R&D (research and development) tax credits are to be increased from 150% to 175% for small and medium-sized businesses and from 125% to 130% for large businesses.
- Proposed 'income-shifting' legislation, which could be used to tax one person on income which that person diverted to another person in order to save tax, is to be postponed until 2009.
- The limit for 'self-correction' of VAT errors without having to notify HM Revenue and Customs is to increase from £2,000 to £10,000 from 1<sup>st</sup> July 2008.
- From 6<sup>th</sup> April 2008, days will be counted for the purposes of determining whether a person is resident in the UK if that person is present in the country at midnight. (And not both the days of arrival and departure as previously proposed.)

# Appendix

## UK Tax Rates and Allowances: 2006/7 to 2008/9

	Rates	Bands, allowances, etc.		
		2006/7 £	2007/8 £	2008/9 £
<b>Income Tax</b>				
Personal allowance		5,035	5,225	5,435
Starting rate band	10%	2,150	2,230	(1)
Basic rate band (2)	20%	31,150	32,370	36,000
Higher rate:	40%			
Normal higher rate threshold:		38,335	39,825	41,435
<b>National Insurance Contributions</b>				
Class 1 – Primary	11%	)	On earnings between earnings threshold and	
Class 4	8%	)	upper earnings limit.	
Earnings threshold		5,035	5,225	5,435
Upper earnings limit		33,540	34,840	40,040
Class 1 – Secondary	12.8%	- On earnings above earnings threshold.		
Class 1 & Class 4	1%	- On earnings above upper earnings limit.		
Class 2 – per week		2.10	2.20	2.30
Small earnings exception		4,465	4,635	4,825
Class 3 – per week		7.55	7.80	8.10
<b>Pension Contributions</b>				
Annual allowance		215,000	225,000	235,000
Lifetime allowance		1.5M	1.6M	1.65M
<b>Capital Gains Tax</b>				
Annual exemption:				
Individuals		8,800	9,200	9,600
Trusts		4,400	4,600	4,800
<b>Inheritance Tax</b>				
Nil Rate Band		285,000	300,000	312,000
Annual Exemption		3,000	3,000	3,000
<b>Pensioners, etc.</b>				
Age allowance: 65-74		7,280	7,550	9,030
Age allowance: 75 and over		7,420	7,690	9,180
MCA: born before 6/4/1935		6,065	6,285	6,535
MCA: 75 and over		6,135	6,365	6,625
MCA minimum (3)		2,350	2,440	2,540
Income limit		20,100	20,900	21,800
Blind Person's Allowance		1,660	1,730	1,800

### Notes

1. For 2008/9, a 10% starting rate band of £2,320 applies to interest and other savings income only.
2. Basic rate on income other than interest, dividends and other savings income is 22% until 5 April 2008. The rate applying to dividends is 10%.
3. The Married Couples Allowance, 'MCA', is given at a rate of 10%.

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