

The 2008 Pre Budget Report

VAT

On 24th November, the Chancellor delivered his second Pre Budget Report (PBR). His first, in October 2007 contained several shocks: dramatic changes to capital gains tax (CGT) and to the rules for non residents and the non UK domiciled. His second was no less dramatic.

The reduction in the main rate of VAT from 17.5% to 15% (to 31st December 2009) had been widely leaked in the weekend press and caused little surprise. Allowing traders only a week to change the rate in their accounting software, tills and on price labels has given rise to some practical difficulties. Many commentators have suggested that the reduction will not in fact be passed on and others have questioned whether such a small cut – even though it is the largest the government can make under EU law – will actually boost consumer spending.

There are a number of technical issues for businesses, particularly those supplying goods before the change and issuing credit notes afterwards, those in the special VAT flat rate scheme and those supplying services spanning the change of rate. H M Revenue and Customs has issued detailed guidance on their website at <http://www.hmrc.gov.uk/pbr2008/measure1.htm>. This is a very expensive measure – costing over twelve billion pounds – and represents a huge gamble: it will only work if the tax lost to the Exchequer is actually pumped back into the economy rather than being added to consumers' savings.

Other business taxes

The lower rate of corporation tax will not now rise from 21% to 22% as planned next April. This is helpful but it must be remembered that only a couple of years ago the rate was 19% and that when many businesses incorporated, the rate on the first £10,000 of profit was zero.

A new relief will allow limited business losses to be set back against profits of the previous three years. Companies will be able to set back losses of accounting periods ending between 24 November 2008 and 23 November 2009 and unincorporated businesses - the self employed - will be able to set back any losses for the 2008/9 trading year. The relief will permit the full loss to be set back one year and up to £50,000 of the remaining loss to be set back to the two years before that.

One very welcome measure which received very little publicity was the announcement that the government has shelved plans to attack "income shifting", where husband and wife companies or partnerships split income between the shareholders or partners in a way that HMRC regards as non-commercial with the result that tax is saved. This is very good news for thousands of businesses in the UK.

Another welcome announcement was the launch by HMRC of a new Business Payment Support Service. This is a more formalised version of the approach that HMRC took during the foot and mouth crises and is designed to help struggling businesses to meet their tax liabilities. The idea is that the Service will help by agreeing less rigid payment terms in appropriate cases. Full details are on HMRC's website at <http://www.hmrc.gov.uk/pbr2008/business-payment.htm>.

The Chancellor proposes to pay for the reduction in the rate of VAT in a number of ways, one of which is an increase in national insurance (NI) from 5th April 2011. The rate of NI for both employers and employees and the class 1A and 1B NI on benefits will increase by 0.5%. Class 4 NI paid by the self employed will also increase by 0.5% as will the additional rate paid by both the employed and self employed.

A non-tax announcement of interest to small businesses is the Small Business Finance Scheme, a new initiative to provide £1 billion of government supported lending by banks. This will be launched early in 2009.

There will also be a new £50 million fund to provide equity or “quasi equity” to small and medium sized businesses that are over-leveraged and a temporary special guarantee scheme for smaller exporters.

Individuals

There is good news and bad news on personal taxation.

The £600 increase in the basic personal allowance designed to compensate for the abolition of the 10% tax rate in April 2008 will be extended to the next tax year, when its value will be further increased to £730. The basic personal allowance will be £6,475 for 2008/9. Pensioners will receive an extra one-off payment of £60 in January and from April there will be an increase in the basic state pension to £95.25 a week. There will also be increases in Child Benefit and Child Tax Credits.

From 6th April 2010 the basic personal allowance will be reduced in two stages for those with income above £100,000. Half of the allowance will be progressively clawed back by £1 of allowance for every £2 of income for those with incomes between £100,000 and £140,000; the remaining half will be clawed back at the same rate when income is above £140,000. From 6th April 2011 there will be a new tax rate of 45% for income above £150,000 and a new rate for dividends over that amount of 37.5%. The trust rate of tax will also be increased from 40% to 45%.

Summary

The Chancellor has taken a huge gamble with this package. Significant government borrowing will be needed to fund it until the economy recovers. If recovery is delayed, further tax measures can be expected.

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