PRE-BUDGET REPORT 6 DECEMBER 2006
Summary of the Main Taxation Provisions

This year's Pre-Budget Report is almost certainly Gordon Brown's last as Chancellor. On this occasion, his March 2006 Budget predictions for growth and borrowing have proved reasonably accurate, even if overall borrowing is still at an uncomfortably high level. While Mr Brown's speech itself contained very few surprises, the supporting material issued by the Treasury and HM Revenue & Customs (HMRC) revealed a wide variety of important tax measures.

Tax allowances and National Insurance Contributions
The basic personal allowance and starting point for national insurance contributions (NICs) will rise in 2007/08 to £5,225. The main rates of employers', employees' and Class 4 NICs will stay unchanged. The flat rate of NICs for the self-employed will rise to £2.20 a week for 2007/08. A full list of the 2007/08 income tax allowances and NIC rates and thresholds is set out at the end of this summary.

Tax credits
The main elements of working tax credit will rise broadly in line with inflation in 2007/08, but the first income threshold for working tax credit will remain frozen for the third year at £5,220 and there will be no increase in the childcare element.

The child element of child tax credit will increase by 4.5% to £1,845 in 2007/08. However, the family element of child tax credit and baby addition will remain unchanged at £545 for a fourth year.

For those claimants who are not entitled to working tax credit, the first income threshold (at which child tax credits, other than the baby and family element, start to be withdrawn) will rise to £14,495. The second threshold (at which the baby and family elements start to be withdrawn) is again unchanged at £50,000.

Alternatively Secured Pensions
Several important changes will apply to alternatively secured pensions (ASPs) from 6 April 2007. ASP is a form of pension fund withdrawal available to pension scheme members from age 75, which was introduced with effect from April 2006.

- A minimum income requirement will be introduced of 65% of the annual amount of a comparable annuity for a 75 year old. There is currently no minimum income level.
- The maximum annual income will rise from 70% to 90% of the annual amount of a comparable annuity for a 75 year old.
- On the death of an ASP member or on the death of a dependant, a transfer of any remaining ASP funds to the pension funds of other members of the scheme (a transfer lump sum death benefit) will become an unauthorised payment, and will be subject to a tax charge of up to 70%. This largely puts an end to the idea of using ASPs to pass pension assets between generations.
- It will no longer be possible to make pension payments for up to ten years under a guarantee from an ASP fund.

The Finance Bill 2007 will also introduce measures to prevent other pension income options, such as scheme pensions paid by small self-administered schemes, being used to pass on pension fund assets. These measures will also take effect from 6 April 2007.

Pension term assurance
A consultation with the pensions industry will explore changes to the pension term assurance regime in time for the next Budget. The government believes that the existing rules are being exploited to obtain tax relief for pure life cover. Any changes will not affect personal policies entered into before 6 December 2006 or existing employer arrangements. This might signal the end of stand-alone personal pension term assurance.

Other pension measures
There will be a number of 'technical improvements' to the pensions tax framework, eg revising the rules on ill-health pensions to allow them to be reduced rather than only stopped in full, as now. The amendments will be included in the Finance Bill 2007, but most will have effect from 6 April 2006.

Individual Savings Accounts and Personal Equity Plans
The following changes are to be made to personal equity plans (PEPs) and individual savings accounts (ISAs), as previously announced:

- The lifetime of ISAs is to be extended indefinitely.
- The overall annual investment limit for ISAs will be 'at least £7,000'.
- PEPs will be brought within the ISA regime and the PEP rules scrapped. However, there will be no compulsion on providers to merge accounts.
- The distinction between Mini-ISAs and Maxi-ISAs will disappear, but the monetary limits for the two components will remain.
- Transfers from an ISA cash component into the stocks and shares component for past tax years will be possible without affecting the current year's investment limits.
- Child Trust Fund accounts will be able to roll over into ISAs on maturity.

The intention is to implement all of the changes 'as soon as possible', with the exception of the Child Trust Fund measure.

Real Estate Investment Trusts
A range of legislative and regulatory revisions will be introduced to make it easier for a newly-established company to become a UK Real Estate Investment Trust (REIT). For example, a company will no longer need to have its shares listed on a recognised stock exchange on the date it gives notice of conversion to a REIT, provided it expects to be listed by the time it joins the REIT regime. The measures will have effect on or after 1 January 2007.

Other REIT changes will be introduced in response to problems identified in the implementation of the new tax regime, for example ensuring that charities are exempt from tax on distributions from REITs.

If an investment-related pension scheme, such as a self-invested personal pension, holds 10% or more of a REIT (either alone or with associates), it will be treated as having an indirect holding in any taxable property held by the REIT. The measure is designed to prevent REITs being used to sidestep the anti-avoidance rules relating to pension scheme investment in residential property.

Construction industry scheme
The new construction industry scheme to be introduced on 6 April 2007 will have a standard deduction rate of 20%, instead of the present 18%. A new higher deduction rate of 30% will apply to unregistered sub-contractors to enable them to start work and encourage them to register.

Managed Service Companies

Managed service companies (MSCs), sometimes called composite companies, have been used to bypass the anti-avoidance legislation aimed at personal service companies, often referred to as the IR35 rules. A consultation document has been issued, together with draft legislation, which would make members of MSCs subject to income tax and NICs in the same way as employees. Measures will be introduced in the Finance Bill 2007 with effect from 6 April 2007.

Planning Gain Supplement

The government published three consultation papers on the design and implementation of its proposed planning gain supplement (PGS). The rate of PGS will be 'modest' and the new tax will not be introduced earlier than 2009.

Landlord's Energy Saving Allowance

A number of changes will be made to the Landlord's Energy Saving Allowance from 6 April 2007:

- Its availability will be extended to 2015.
- Qualifying expenditure will be widened to include installation of floor insulation.
- The present cap of £1,500 will be applied to each property rather than to each building.
- The allowance will be made available to corporate landlords who let residential properties.

Microgeneration

The Finance Bill 2007 will confirm that, where private householders install microgeneration technology in their home to generate power for their personal use, they will not pay income tax on any payments they receive from the sale of surplus power to an energy company.

Air passenger duty

Air passenger duty is to be doubled for flights made after 31 January 2007. The minimum rate (eg for lowest class travel within the EEA) will rise to £10 and the maximum will be £80.

Value Added Tax

There will be changes to the VAT partial exemption regime with effect from 1 April 2007. Businesses will have to declare the suitability of their proposed 'special method', for the calculation of VAT liability, before it is approved by HMRC. The aim is to speed up the approvals process.

VAT record-keeping requirements for businesses transferred as a going concern will be brought into line with other regulatory regimes so that the seller retains the records, except where the buyer retains the seller's VAT number.

Six year limitation period for all direct tax claims

The government will legislate to ensure that the limitation period for the recovery of direct tax paid by mistake of law will be six years from the date of payment. This is consistent with the limitation period for making claims in respect of direct taxes paid under assessment as a result of a mistake in a tax return. The provision will have retrospective effect, but will not disturb the entitlement of those who have secured what amounts to a final House of Lords judgment in their favour before 6 December 2006.

Tax avoidance measures

As usual, HMRC's notes revealed a range of anti-avoidance measures, many of which have been prompted by information supplied under the disclosure regime. There are six measures aimed at corporation tax, one aimed at stamp duty land tax and one targeting capital gains tax.

Income tax – personal and age-related allowances 2007/08

	2007/08
	£
Personal allowance (age under 65)	5,225
Personal allowance (age 65-74)	7,550
Personal allowance (age 75 and over)	7,690
Married couple's allowance* (aged less than 75 and born before 6 April 1935)	6,285
Married couple's allowance* (age 75 and over)	6,365
Married couple's allowance* (minimum amount)	2,440
Age allowances income limit	20,900

* Tax relief for the married couple's allowance is given at the rate of 10%, and is only available where at least one spouse was born before 6 April 1935. The same allowances and conditions apply for civil partners.

National insurance contributions

	2007/08
Lower earnings limit, primary Class 1	£87 a week
Upper earnings limit, primary Class 1	£670 a week
Primary threshold	£100 a week
Secondary threshold	£100 a week
Employees' primary Class 1 rate	11% of £100.01 to £670 a week 1% above £670 a week
Employees' contracted-out rebate	1.6%
Married women's reduced rate	4.85%
Employers' secondary Class 1 rate	12.8% on earnings above £100 a week
Employers' contracted-out rebate, salary-related schemes	3.7%
Employers' contracted-out rebate, money-purchase schemes	1.4%
Class 2 rate	£2.20 a week
Class 2 small earnings exception	£4,635 a year
Special Class 2 rate for share fishermen	£2.85 a week
Special Class 2 rate for volunteer development workers	£4.35 a week
Class 3 rate	£7.80 a week
Class 4 rates	8% of £5,225 to £34,840 a year 1% above £34,840 a year
Class 4 lower profits limit	£5,225 a year
Class 4 upper profits limit	£34,840 a year

Links

http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr06/prebud_pbr06_index.cfm
http://www.hmrc.gov.uk/pbr2006/index.htm

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