

Budget Summary

This was the eleventh and possibly last Budget presented by Chancellor Gordon Brown. The Chancellor presented a neutral but highly complex budget which gives with one hand and takes with another. In reality the Chancellor has effectively raised taxes for many smaller businesses and as always, once we go beyond the headline and completely unexpected reductions in standard rate income tax and corporation tax the detailed measures need careful reading and interpretation. We really should not be surprised that this has happened, partly because the public finances allowed very little room for tax cuts and partly because there are obvious political undertones as we move into a possible General Election over the next year or two. Many smaller hospitality businesses will however be worse off and it is unlikely that consumers will feel any better off. Meanwhile storm clouds are gathering over the global economy and inflation is a constant threat which may make trading conditions more difficult in the latter half of 2007 and into 2008 but on the bright side UK economic growth is set to grow by between 2.75 and 3.25% in 2007.

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A Budget for prosperity?

Budget highlights

- ◆ Corporation tax down from 30 to 28% from April 2008
- ◆ Small business tax raised from 20 to 22% in three stages by 2009 ostensibly to prevent tax avoidance by individuals; the extension of the current 50% first year capital allowance extended by one year to April 2008
- ◆ Basic rate of income tax cut by 2p to 20p from April 2008 and 10p rate abolished
- ◆ Phased alignment of 40% income tax and national insurance thresholds
- ◆ Capital gains tax annual exemption raised from £8,800 to £9,200 in 2007/2008
- ◆ Inheritance tax threshold to be increased from £285,000 to £350,000 by 2010
- ◆ Duty on beer raised by 1p a pint, 5p on a bottle of wine, cider 1p per litre and 7p on a litre of sparkling wine
- ◆ Biofuels to continue to have a lower duty until 2010
- ◆ 11p on a pack of 20 cigarettes with VAT on nicotine replacement therapies cut from 17.5% to 5% for one year beginning 1 July 2007
- ◆ Vehicle excise duty on gas-guzzling cars rises by 30% to £300 this year and £400 in April 2008; duty on most fuel-efficient cars reduced from £50 to £35
- ◆ Duty on fuel rises by 2p a litre from October 2007, rising a further 2p in 2008 and a further 1.8p in 2009

- ◆ Rates relief on vacant industrial properties restricted to six months from April 2008; all other vacant commercial property will be entitled to only three months relief after which full rates are payable
- ◆ Stamp duty rates left at current rates but zero-carbon houses worth up to £500,000 will be exempt until 2012
- ◆ Child benefit rises from £17.45 to £20 a week for the first child by 2010
- ◆ Free nursery education increased from 12.5 to 15 hours a week
- ◆ Individual savings accounts (cash Isas) annual limit increased from £3,000 to £3,600 in April 2008; the total sum for stock and share Isas will be increased to £7,200 each year
- ◆ The rate of duty on internet gaming businesses increased to 15% in line with offline bookmakers and bingo operators but VAT not removed on bingo which is an anomaly
- ◆ A new gaming duty structure introduced which will raise taxes for all casinos with the largest casinos paying 50%
- ◆ An additional £8 billion for the NHS in England in 2007-2008 and for the UK as a whole an additional £10 billion
- ◆ Personal allowances for pensioners over 65 raised by £1,180 above normal indexation from April 2008 and pension credit or guaranteed minimum pensioner income will rise in line with earnings from £114 a week to £130 by 2009-2010
- ◆ The Financial Assistance Scheme for those who have lost their pension through company insolvency increased from £2 billion to £8 billion
- ◆ Teenagers will have the right to stay at school or in job-related training until 18 and 50,000 16 and 17 year-olds will be paid a training wage if signed up for courses

The economy

The Chancellor delivered a 48 minute Budget speech which will have broadly neutral effects on the UK economy. As we mentioned after last years Budget - when the economy is relatively stable we can expect budgets which are broadly neutral.

The economic growth forecast made by the Treasury in December remains unaltered - the economy is expected to grow by between 2.75% and 3.25% in 2007, whereas most economic commentators have made a somewhat lower forecast at an average growth of 2.6%. The Chancellor has also left unaltered his growth forecasts for 2008 and 2009 of between 2.5% and 3%, compared with an average growth rate of 2.3% predicted by economists. Consumer spending is forecast to grow by about 2.5% each year between 2007 and 2009; this lower rate of growth compared with GDP growth reflects the slower growth of real disposable incomes and the effects of three recent interest rate rises. Business investment however, is forecast to grow by around 7% in 2007, rather stronger than the 5.5% forecast in December 2006.

We have become used to real increases in public spending in recent years but for the next four years public spending will slow down to just 2% a year in real terms after taking account of inflation. Once we factor in the measures announced last December the overall impact is to pull in an extra £2 billion in tax in each of the next three tax years up to April 2010. To finance the tax cuts and make up the shortfall from lower

than expected corporation tax receipts (down some £4.5 billion this year) and North Sea tax (down by around £2 billion) the Chancellor was forced yet again to borrow. Since 2000 the Chancellor has borrowed around £100 billion more than he had originally intended. In the next four years the Treasury will be borrowing an extra £10 billion, borrowing a total of £84 billion between 2007-2008 and 2010-2011

How it affects you

At first sight the Budget is reducing two headline taxes – the basic rate of income tax and corporation tax and most people would be pleased about this but although the Chancellor did not say so, these income tax reductions are paid for first, by abolishing the 10p income tax band and increasing the upper earnings limit for national insurance which will be aligned with the £43,000 starting rate for 40% tax and second, by increasing for many small businesses the overall tax burden by around £3.8 billion via a reduction in capital allowances.

Mainstream corporation tax is being reduced from 30 to 28% from April 2008 and this may make Britain a more attractive location for large multinational companies. This is the first cut in corporation tax since 1999. This new rate is below America, France, Germany and Japan, but still well behind Ireland (12.5%) and Poland (19%) but nevertheless moves the UK from 15th to 8th position in the ranking of the 30 OECD countries. This change will save some companies around £2 billion in 2009-2010 but the small companies' tax rate (payable on profits up to £300,000) will be raised in three stages from 20% this year to 22% in 2009, costing the Treasury up to £3 billion and small businesses themselves around £820 million. The increase in small companies' tax is intended to close a loophole where some small companies have been established primarily to reduce individual tax liabilities but the tax increase has met with severe criticism by small business leaders. There are concerns that while the cut in mainstream corporation tax will save companies money, the changes to capital allowances on investment in plant, machinery and property will mean that the Treasury claws back this cash. There were however, some incentives for small business investment with an extension to the first year capital allowance of 50% and the introduction of 100% relief for capital expenditure of up to £50,000 on general plant and machinery (other than cars) from April 2008 (an Annual Investment Allowance) but most qualifying plant and machinery allowances fall from 25% to 20%. There is an increase in the rate for long-life assets of about 25 years, from 6% to 10%, which should be of some benefit to some companies but overall those companies not spending on capital items will suffer an increase in their tax burden.

The Chancellor has also agreed to increase the tax allowance on research and development expenditure but this is unlikely to affect hospitality businesses. So overall businesses in a capital intensive industry such as hospitality with large property portfolios are likely to be worse off, and initial negative impacts on cash flow could be quite severe for those businesses who invest in more capital equipment this coming year.

The industrial buildings allowance, which helped manufacturers, is being abolished and suggests that the Chancellor has decided not to be sector-specific in promoting allowances although overall commentators are suggesting that the service sector and financial services in particular will benefit the most from this Budget. For years we

have heard how the government wishes to promote enterprise but this tax increase will hit small businesses which are seeking to grow; this is regrettable.

Industrial property owners are upset over plans to reduce rates relief on empty commercial property. The government hopes to promote the redevelopment of empty buildings but there are fears that the exact opposite will happen and some owners will partially demolish the building in order to pay no rates at all. Up to now owners of industrial property could obtain 100% rate relief while buildings were unoccupied, while owners of all other commercial property, including retail outlets and offices, receive 100% relief for the first three months and 50% thereafter. From April 2008 industrial property owners will obtain 100% relief only for the first six months when a building is vacant while all other empty commercial properties will have three months rates relief and then will be charged the full amount. This will net the Treasury another £950 million in the 2008-2009 tax year and £900 million a year thereafter.

As with previous Budgets in recent years duty on beer, cider and wine has gone up as from 25 March but has continued to be frozen on spirits. Although the amounts are relatively small nevertheless hospitality businesses are forced to pass on these duties in higher prices at a time when consumers are very sensitive to inflationary pressures.

Other measures

The Chancellor announced a rise in gaming duty to 50% for the new super casino planned for Manchester (provided Parliament approves). Gordon Brown also has indicated that he is unlikely to give approval for more super casinos. He also announced that the new tax on internet gambling sites based in Britain will be 15% and this may well deter such companies moving to the UK. The rise in gaming duty by 10% will be applicable to large casinos that make a “gaming yield” (the amount placed as bets minus the winnings paid out) of more than £10 million a year. Smaller casinos also face increases in duty. From 1 April 2007 the 2.5% starting rate of gaming duty is abolished and the 12.5% rate increases to 15%. The Treasury argues that it needs to ensure that the gaming industry makes “a fair contribution to tax receipts”. These are calculated to rise to £30 million this year and £35 million in subsequent years. Commentators are suggesting that these tax increases may discourage operators from bidding to run both the new super casino and the new smaller casinos which were announced in January. The Rank Group estimates that these tax rises will cost it £8 million in a full tax year while the British Casino Association estimates that the changes will cost operators around £100 million over three years. Bingo operators had hoped for an abolition of VAT to offset the additional costs of the smoking ban.

Revenue & Customs is to be given new powers to investigate experts who devise tax avoidance schemes but who do not tell Revenue & Customs. It was the 2004 Budget which required tax advisers to inform Revenue & Customs about any avoidance schemes devised for clients. It is believed that fines of up to £50,000 are planned for non-disclosure of such schemes many of which use capital losses to offset gains.

The offering to small companies that take on staff lacking basic skills of up to £3,000 in training funds per employee is to be welcomed but the phased increase in fuel

duties will push up business costs. If global energy prices increase again over the autumn some transport companies could really feel the pressure in the winter of 2007-2008.

The Budget's package of measures to help families and children are welcomed as the government attempts to meet its 2010 target of halving child poverty. Households with children will, on average, be £200 a year better off while those in the poorest 20% of the population will, on average, be £350 a year better off. Changes will be made to working tax credit (WTC) paid to top up the earnings of low income working households together with an increase in child tax credit targeted at the poorest families. From April 2008 the WTC income threshold will go up by £1,200 to £6,420. Child benefit will go up to £20 a week for the eldest child by April 2010. The £40 per week in-work credit paid for 12 months to lone parents going back to work is being extended to June 2008 and would rise to up to £60 a week in London. This tax free credit paid in addition to wages and other tax credits is worth just over £2,000 outside London (and £3,120 in London) in the year an eligible lone parent returns to work. The Budget also pledges to provide free childcare places for up to 50,000 out of work parents undertaking training courses, thus enabling more to return to work. All these changes will have a positive impact on significant numbers of hospitality workers.

Savers were rewarded with the maximum amount that can be invested in a cash Isa increasing from £3,000 to £3,600 from April 2008, but there was disappointment that the annual limit for equity Isas has only risen by £200 to £7,000. Isas are hugely popular and since they were launched in 1999 some 17 million people have invested more than £220 billion in them.

Those workers who lost their pensions when their employers went bust have been given the possibility of additional help. An extra £6 billion has been put into the pensions rescue fund (the financial assistance scheme). The Chancellor says that raising the fund to £8 billion will cover the claims of 125,000 workers and secure 80% of their expected retirement incomes but not index-linked it appears. Critics say however that this additional money will be spread over 60 years.

Education spending continues to grow. The Chancellor pledged annual increases of 2.5% in real terms, and education spending will increase from £60 billion to £74.4 billion in 2010-2011. This represents a significant slowdown. Higher education will continue to expand, rising from 1 million to 1.2 million students. Apprenticeships will double to 500,000 and 50,000 16 and 17 year olds who enter "activity and learning agreements" will receive a £2,000 training wage. Military spending will increase by £400 million in 2008, taken from the special reserve, for operations in Iraq and Afghanistan. Operations in these two countries have cost £1.7 billion over the last year. There is however a battle between the Ministry of Defence and the Treasury over the total defence budget which now stands at £33 billion (or 2.2% of GDP).

Finally, the Treasury hopes to raise another £36 billion over the next four years by selling off a range of public assets such as student loans and certain Ministry of Defence land. Some £12 billion of public assets have been sold already but future sales could include the Tote betting operation and mobile phone spectrums. In the

past the government raised £22.5 billion from selling licences to operate 3G mobile services.

Conclusions

True to form this is a give and take budget of considerable complexity with far-reaching political consequences. Take away the main headline tax reductions in mainstream corporation tax and basic rate income tax and what is revealed is a mixed picture of increased taxation of small businesses but with significant income improvements for the low paid and pensioners. The vast majority of middle-income people will however feel the effects as progressive increases in fuel duties, national insurance and other measures take effect over the next three years. The end result is a population of consumers likely to feel somewhat hard done by, even if the overall effect is broadly neutral, and if inflation continues to increase, coupled with a series of interest rate rises to contain it, then we are likely to see consumers pulling their belts in, and as a consequence, they may well reduce their expenditure on eating out and holidays. The Chancellor has however, simplified the income tax and national insurance system, even if it was he who introduced the 10p income tax band in the first place. A simplified tax system is nevertheless to be welcomed.

The hospitality industry can be forgiven for thinking that there is much to dislike in this Budget and all the rhetoric about developing an enterprise culture is ringing somewhat hollow but the economy is still growing, albeit at a somewhat decreasing forecasted rate in 2008-2009, unemployment is at historically low rates and interest rates are still at low levels, but for how much longer? Much depends on the global economy over the next two years but on current evidence the economy is still in pretty good shape.