

Budget Summary

This was the first Budget presented by Alistair Darling and the 12th Budget under a Labour government. Given a turbulent international economy there was little room for manoeuvre but the Chancellor chose to target the poorest families, pensioners and climate change. There was little in this rather austere Budget which will be of comfort to hospitality businesses. Growth forecasts have been reluctantly revised downwards by the Treasury (to between 1.75 and 2.5%) but government borrowing is up, rising by £43 billion or some £7 billion more than the Treasury had predicted just a short while ago, and overall there is a net increase in taxes especially on alcohol. The Chancellor is hoping that the government's economic model will ultimately work and the UK economy will come through a global slowdown. The rising cost of living, the increased government borrowing and a general nervousness about the financial system and housing market all combine to promote an air of gloom. Given the economic slowdown (which is not to be confused with a recession) the Chancellor could not aggressively raise taxes nor dispense largesse. Accordingly at first sight this looks a rather dull Budget given that many major tax changes had already been announced in last year's Budget but as always the devil is in the detail.

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A Budget for stability?

Budget highlights

- ◆ Alcohol duty increased with 4p on a pint of beer, 14p on the average bottle of wine and 55p on a bottle of spirits
- ◆ Introduced an alcohol accelerator of above inflation duty rises for several years
- ◆ 11p on a packet of cigarettes and 4p on a pack of five cigars
- ◆ Pensioners winter fuel allowance increased to £250 and £400 for the over-85s
- ◆ Revenue from airplane fuel duty expected to increase by 10%
- ◆ The expected 2p fuel duty rise due in April delayed until October although from 2010 duty will rise by 0.5p a litre in real terms
- ◆ New showroom tax for large family cars; from April 2009 vehicle excise duty to be changed with new rate bands to encourage the manufacture of cleaner cars
- ◆ From April 2010 no car tax will be paid in the first year on new cars that emit less than 130 grammes per kilometre of CO₂ but there will be a higher first year rate for more polluting cars
- ◆ Provision of a £12.5 million fund to encourage more women entrepreneurs

- ◆ The threshold for businesses to account for VAT on a cash basis will increase from £660,00 to £1.35 million in April
- ◆ Funds for the loan guarantee scheme for small businesses will be increased by £60 million
- ◆ All main income tax allowances rise by 4% in line with the retail price index
- ◆ The government will aim for small businesses winning 30% of public sector business
- ◆ Stamp duty on shared-ownership homes will not be required until the buyers own 80% of the equity
- ◆ Treasury consultation on achieving affordable long-term fixed-rate mortgages with report back at the Pre-Budget Statement time this coming autumn
- ◆ £765 million next year and additional £95 million the following year to target child poverty (estimated to take 250,000 more children out of poverty)
- ◆ From April 2009 the child element of the child tax credit for families on low and middle incomes to increase by £50 a year above inflation
- ◆ Child benefit rises to £20 for the first child next year
- ◆ 5 million customers on pre-payment meters to be given a better deal with legislation if required
- ◆ Increase of £2 billion spending on defence and specifically frontline troops and their equipment
- ◆ New funding to develop technology for national road pricing to ease congestion
- ◆ Supermarkets encouraged to charge for plastic carrier bags and money raised given to environmental charities, but will be forced by legislation if don't do this
- ◆ Review of public sector land identified sites for 70,000 more homes
- ◆ New biometric technology measures at Heathrow and other airports to speed up immigration control processes
- ◆ £200 million invested in schools to improve GCSE grades
- ◆ By April 2010 all long-term recipients of incapacity benefits will face work assessments

There were also a number of measures which were actually announced in last year's Budget or were announced in recent months, and are merely confirmed as going ahead, these include:

- ◆ The previously announced main corporation tax fall from 30 to 28% as from April
- ◆ Confirmed small business corporation tax to rise to 21% in 2008/2009 and 22% in the following year
- ◆ Confirmed new capital gains tax 18% rate on both business and non-business assets including entrepreneurs relief as from April 2008
- ◆ Non-domicile tax scheme confirmed as starting from April but no further changes in this or the next Parliament
- ◆ Confirmed inheritance tax 40% threshold rises from £300,000 to £312,000 with plans to increase to £350,000 by 2010/2011
- ◆ Confirmed annual ISA investment limit raised to £7,200 from April and the mini cash ISA increased to £3,600
- ◆ Confirmed 10% income tax on first £2,230 of earnings abolished as from April and basic rate income tax on earnings between £2,231 and £34,600 falls from 22 to 20% as from April this year

- ◆ The upper earnings limit on national insurance contributions is confirmed as increasing from £670 per week to £770 per week

The economy

The Chancellor began his Budget speech, which lasted 50 minutes, by saying he was presenting a responsible Budget that seeks to maintain stability for the British economy in conditions of global insecurity. He felt that the economy was better prepared for future challenges while confronting child poverty and climate change.

As expected the Chancellor downgraded forecasts for economic growth this year to between 1.75 and 2.25%, compared with a range of 2 to 2.5% forecast in the Pre-Budget Report last autumn, yet even this is considered by some economic commentators to be optimistic. Growth forecasts for 2009 are in the range of 2 to 2.5% (reduced from 2.5 to 3%) again on the optimistic side and we can reasonably ask whether even these growth forecasts will be further downgraded in the months to come?

Public spending growth is due to slow somewhat to an average of 2.2% in real terms over the next three years but the Chancellor is assuming that it will continue to grow at a rate of 1.9% after 2011. The global credit crunch is widely expected to cost the government at least £20 billion over the next four years quite apart from the costs so far of bailing out the failed Northern Rock bank. The cost of national debt servicing is now 5% of public spending. Government debt levels are forecast to keep creeping up from 38.5% of GDP to 39.4, 39.8, 39.7 in the following three years and 39.3% in 2012/2013 while government borrowing which was £36.4 billion in 2007 is forecast to rise sharply to £43 billion in 2008 (a staggering £7 billion revision upwards from the previously forecast £36 billion), £38 billion in 2009 and £32 billion in 2010. It is quite possible that government borrowing will exceed the record £50 billion set by Norman Lamont, Chancellor at the time of severe economic troubles in 1992. Income tax receipts are expected to fall by £1.6 billion in 2008 rather than the usual £5 to £7 billion increase in a typical tax year; this is due, we are told, to the impact on City jobs and bonuses. Some economic commentators believe that £8 billion of tax increases are needed just to put the public finances back on track but the government would find this difficult as economic slowdown continues during 2008 – heavy tax increases would merely lead to consumers reining in spending even more and businesses postponing investment decisions.

The government's fiscal operating statements will worsen once the impact of the Northern Rock nationalisation is brought on to the books. The Office for National Statistics (ONS) said in February before the bank was nationalised, that the extent of public control over the bank was sufficient to classify it as a public body. The ONS publishes figures including Northern Rock in April. The full extent of Northern Rock liabilities is now £100 billion and when this is added to the national debt the government's rule of national debt remaining below 40% of national income will be well and truly breached.

Higher inflation during 2008 and 2009 is forecast which means that the Bank of England will be very cautious in cutting interest rates. We predict that interest rates will not continue to be cut at the speed at which some are currently forecasting.

Interest rates are anyway at the best of times a pretty crude weapon in the fight to maintain economic stability and even then after interest rate changes, there are considerable time lags before the economy responds.

How it affects you

Alcohol duty, was as predicted, raised by 6% above inflation, with 4p on a pint of beer, 14p on the average bottle of wine and 55p on a bottle of spirits. The duty increase on spirits comes after 10 years of a duty freeze but nevertheless is the biggest rise since 1991. These duty increases will hit the pub and restaurant sectors hard and while not unexpected are nevertheless difficult for the hospitality industry to bear. Increases in raw material costs for the brewing industry and now increases in duty could lead to the further demise of the small number of independent brewing companies still left in Britain.

It is calculated that businesses will pay an extra £600 million in taxes in a full tax year and comes on top of an estimated £1.4 billion increase in taxes for businesses last year. No wonder business leaders are fed up. Businesses will receive more than £680 million in tax relief over the next three years but this is more than wiped out by the tax increases. As announced in last year's Budget by the then Chancellor Gordon Brown, mainstream corporation tax is confirmed as being reduced from 30 to 28% from April this year. This is the first cut in corporation tax since 1999 and may make Britain a more attractive location for large multinational companies. 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 (with an unchanged lower profit limit of £300,000 and upper profit limit of £1.5 million, at which point mainstream corporation tax is payable) 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 continuing and severe criticism by small business leaders. There are concerns that while the cut in mainstream corporation tax will save companies money, the previously announced changes to capital allowances on investment in plant, machinery and property will mean that the Treasury claws back this cash.

The Chancellor announced a welcome £60 million increase in the Small Firms Loan Guarantee Scheme, which helps small businesses borrow more cheaply. Investors in start-up companies will now be able to put up to £500,000 into a new business (up from £400,000) and obtain tax relief of 20% under changes to the Enterprise Investment Scheme. The limit had previously been £400,000, which means that the maximum tax relief available rises from £80,000 to £100,000. The list of specifically excluded trades for the three available reliefs - the Enterprise Investment Scheme, the Corporate Venturing Scheme and the Venture Capital Trust Scheme, is extended to include shipbuilding and coal and steel production. This will mean that companies whose trade consists primarily of these activities will no longer qualify under these schemes for any relief.

As expected, the previously announced Capital Gains Tax Entrepreneurs Relief was confirmed, which effectively taxes the first £1 million of lifetime gains arising from the disposal of interests in trading businesses at 10% rather than at the new rate of 18% which will apply from this April. This gives a potential lifetime tax benefit of £80,000. It is estimated that some 80,000 taxpayers will benefit from this new measure. The transition to 18% flat rate capital gains tax following abolition of business asset taper relief had brought considerable business condemnation. The introduction of the £50,000 automatic first year allowance for capital expenditure (excluding cars, but including long life assets) will be a helpful simplification for many small businesses. This measure is to be welcomed.

There has been a little noticed provision in the accompanying Budget paperwork concerning pension contributions by employers. The forthcoming Finance Bill 2008 will include provisions confirming that the only amounts a company is allowed to deduct in respect of pension costs are the pension contributions paid to an approved occupational pension scheme in the respective time period. This will be a retrospective measure, effective for accounting periods beginning on or after 1 April 2004 and ending on or before 5 April 2006, and reinstates a provision that had been in earlier legislation but which was deleted from the legislation covering this period. It is confirmed that only cash contributions to pension schemes are allowable deductions for tax purposes, not the expenses shown in the profit and loss account.

New regulations for Property Authorised Investment Funds (AIFs) will be introduced from April 2008. These new regulations provide an alternative to a UK Real Estate Investment Trust (REIT) and the new AIFs will be open-ended investment vehicles. An AIF that invests mainly in property and certain related securities will be able to elect for the Property AIF regime to have effect. In a Property AIF rental profit and certain other property-related income will be exempt from taxation while in the fund. It will normally be distributed to investors after tax deduction. Basic rate taxpayers will have no further tax liability, non-taxpayers and exempt bodies will be able to reclaim this tax, while higher rate taxpayers and some corporate bodies will have further tax liabilities. Other taxable income of the Property AIF will also be distributed to investors under deduction of tax. Investors will similarly be able to either reclaim the tax or incur a further charge as appropriate. UK dividends which are currently not taxable in the fund will remain exempt, as they are for all corporate recipients and will fund dividend payments carrying a tax credit to investors at present. To qualify, Property AIFs will have to meet a number of conditions including incorporation as an open-ended investment company subject to FSA regulation; be engaged in a property investment business which amounts to at least 60% of the business; a “genuine diversity of ownership” condition, whereby the fund is not limited or targeted at only a few specified investments; and limits on the holdings of corporate investors concerning the type and amount of loan financing in the fund. Hospitality business investors interested in these provisions will need to seek professional advice.

The VAT registration and deregistration turnover thresholds will be increased with effect from this April. The VAT registration threshold is increased from £64,000 to £67,000 and the VAT deregistration threshold is increased from £62,000 to £65,000.

Following consultation in May 2007 and as part of the review of HM Revenue and Customs' powers, the time limit for raising assessments for under-declared VAT will be increased by 1 year to 4 years with effect from April 2010. The time limit for taxpayers to obtain refunds of VAT will also be increased to 4 years.

Other measures

There are many relatively small measures which may affect hospitality businesses – many of these relate to anti-avoidance measures, for example, the forthcoming Finance Bill 2008 will ensure that taxpayers will have a right to request a review and appeal against certain listed decisions made by HM Revenue & Customs concerning excise matters. These changes will be of especial interest to excise warehouse keepers and producers of alcoholic drinks amongst others.

From April 2008, all UK resident individuals and non-resident Commonwealth and European Economic Area (EEA) nationals will be entitled to notional tax credit on dividends received from non-UK resident companies. This brings the taxation of these dividends into line with dividends received from UK resident companies, with an effective tax rate of 0% or 25%, depending on whether the individual is a basic or higher rate taxpayer. In 2008/09 this notional tax credit will only be available for small investors, who have less than a 10% holding in the company paying the dividend. This will be extended to all investors from April 2009, subject to the condition that the source country levies a charge similar to UK corporation tax on the corporate profits of the company. Anti-avoidance measures will be put into place to ensure this is not abused.

The Government has begun to outline a comprehensive programme of tax measures aimed at encouraging change in consuming behaviour. These include a possible shopping plastic bag tax from 2009; an increase in fuel duty at 0.5p per litre over and above inflation from 2010; increases in the climate change levy, landfill tax and aggregates duty and a new car showroom tax on the sale of new, heavily polluting cars but with a low rate for low polluting vehicles. The announced petrol duty increase due to be implemented in April has been deferred to October.

Conclusions

This Budget was widely predicted to be a pretty pedestrian affair and we were frankly not disappointed. The Chancellor has chosen the difficult route of increasing government borrowing, increasing certain taxes on alcohol and car usage (although there were no major new tax measures) and helping to some extent the poor, children and pensioners. Growth forecasts are revised downwards for the coming year although expected to pick up again the following year. These growth forecasts are considered to be too optimistic. We can expect UK consumers to be feeling pretty hard up and it is likely that a slowing UK economy will persuade many consumers to increase their savings and reduce their expenditure on eating out and holidays. Confirmation of the increase in small business corporation tax is especially hard to accept in the hospitality industry and flies in the face of repeated government claims that it is business-friendly. These are peculiarly difficult times for hospitality businesses and we can only hope that things will improve next year. We do not believe however that the economic slowdown in 2008 will be as great as some

commentators are gloomily forecasting, and indeed we really must not talk ourselves into something worse than a slowdown. For many hospitality businesses life will be more difficult in 2008 there is no denying, but there will continue to be many businesses for which turnover and profitability will be reasonably strong and may against all the odds actually improve during the year.