PN 1

10 December 2003

PRE-BUDGET REPORT

THE STRENGTH TO TAKE THE LONG-TERM DECISIONS FOR BRITAIN: SEIZING THE OPPORTUNITIES OF THE GLOBAL RECOVERY

The Pre-Budget Report, delivered today by the Chancellor of the Exchequer Gordon Brown, sets out how the Government is meeting its long-term economic goals and taking advantage of the opportunities presented by the global recovery.

Key Pre-Budget Report announcements include:

- confirmation that **economic growth has strengthened**, in line with the Budget 2003 forecast, and that the **Government is on track to meet its fiscal rules** over the economic cycle;

- setting out reforms which will **promote business and enterprise across the** UK, by improving access to finance for small business, reducing red tape and promoting a culture of enterprise;

- taking further steps to **extend employment opportunity for all**, through measures which focus help on disadvantaged groups and deprived areas;

- **tackling child and pensioner poverty**, raising the Child Tax Credit by £180 per year and providing further help with childcare, and ensuring security in retirement;

- promoting **fairness in the tax system** by ensuring that everyone who is able to do so contributes to the extra investment in public services; and

- introducing further **measures to improve the environment**, including proposals to tackle climate change, reduce waste and protect Britain’s natural resources.

MAINTAINING MACROECONOMIC STABILITY

At the start of 2003, global uncertainties weighed heavily on short-term prospects for the world economy. Confidence and demand in the global economy were affected by geo-political tensions, continued volatility on international financial and exchange rate markets and uncertainty regarding growth prospects in the major economies. As an open economy, the UK is inevitably affected by these global developments.

On 9 June 2003, the Chancellor announced that he intended to change the basis of the inflation target in the remit for the MPC. This Pre-Budget Report confirms that the operational target for monetary policy will switch to a target based on the harmonised index of consumer prices, which the National Statistician has named the Consumer Prices Index (CPI) for the UK. The level of the new CPI inflation target is being set at 2 per cent and the switch to the new target will apply from today. The new target is 0.5 percentage points below the previous RPIX-based target, reflecting differences in the way that CPI and RPIX inflation are measured. The level of the new target is set to be consistent with the old target in two years' time – the typical forecast horizon for monetary policy.

The domestic stability delivered by the Government's macroeconomic frameworks has enabled the UK economy to cope well in a challenging global economic environment. Demand and activity have strengthened and GDP grew by 0.6 per cent in the second quarter and 0.7 per cent in the third quarter of 2003. While risks remain, there are now clear signs that world economic activity is strengthening. Sound fundamentals mean the UK economy is expected to build on recent positive developments with GDP accelerating into 2004:

- GDP is forecast to grow by 2.1 per cent in 2003 and by 3 to 3½ per cent in 2004 and 2005, in line with the Budget 2003 forecasts; and

- CPI inflation is expected to rise slowly from early next year to reach its 2 per cent target in 2005 as the effects of recovery in the global economy and this year's depreciation of sterling feed through to higher import prices.

The interim projections for the public finances included in this Pre-Budget Report showing that the Government is on track to meet its strict fiscal rules over the economic cycle:

- the average annual surplus on the current budget over the whole cycle up to 2005/06 is around 0.2 per cent of GDP, equivalent to a margin or surplus in this cycle of £14 billion. The Government is therefore on track to meet the golden rule; and

- public sector net debt is projected to stabilise at 35½ per cent of GDP by the end of the projection period - £64 billion below the 40 per cent level and comfortably meeting the sustainable investment rule.

This includes the commitment to carry forward the £2 billion unallocated special reserve into 2003-04 and add a further £500 million. A further £300 million will be added in 2004-05 to ensure the Government is able to meet its international commitments in Iraq and elsewhere in the war against terrorism.

MEETING THE PRODUCTIVITY CHALLENGE

Productivity growth, alongside high and stable levels of employment, is central to strong long-term economic performance and rising living standards. Productivity growth requires a flexible economy that promotes enterprise and entrepreneurship. The Government's long-term goal is that Britain will achieve a faster rate of productivity growth than its main competitors, through boosting enterprise and by promoting greater flexibility in labour, product and capital markets.

A strong entrepreneurial base is an essential driver of growth and prosperity in a modern economy. The Government's vision is that anybody with the talent, potential and drive to succeed in business should have the opportunity and support to do so, regardless of their background. Measures to enhance enterprise and boost productivity announced in the Pre-Budget Report include:

- **reforms to reduce the regulatory burden on enterprise**, including **improvements to the VAT flat-rate scheme,** to ensure more growing businesses can benefit fully from compliance savings;

- **measures to overcome barriers to raising finance for small business**, including a pathfinder round of Enterprise Capital Funds and enhancements to Venture Capital Trusts and Enterprise Investment Schemes;

- launching **an independent review of the Small Firms Loan Guarantee,** to ensure its effectiveness;

- **measures to support regional growth**, including details of the Local Authority Business Growth Incentives scheme, which will boost the role of local authorities in promoting growth and, in Enterprise Areas, a Business Premises Renovation Allowance;

- **a new, clearer and more accessible R&D tax credit** definition which will promote the development of science and innovation;

- **measures to promote a step change in the UK's enterprise culture**, including supporting a national campaign by Enterprise Insight;

- an **extension of Employer Training Pilots** for a third year, to encourage skills training for a third year, and to cover over a third of the country;

- publication of the **interim report of the Barker Review** on the factors affecting housing supply in the UK; and

- consulting on the most appropriate structure for **tax transparent property investment trusts**, as recommended by the Barker Review.

INCREASING EMPLOYMENT OPPORTUNITY FOR ALL

The Government's long-term goal is employment opportunity for all - the modern definition of full employment. It aims to ensure a higher proportion of people in work than ever before by 2010. Worklessness, particularly on a long-term basis, is a constraint on the economy's growth potential and a major cause of poverty and deprivation, entailing costs for individuals, households and society as a whole.

Delivering full employment requires that everyone should be able to take advantage of the opportunities offered by a stable, enterprising economy. To pursue its aim of full employment, the Government proposes:

- **extra support to help the unemployed** by piloting mandatory short intensive work-focused courses at the after 6 months on JSA;

- **enhanced help for lone parents**, increasing the number of work-focused interviews that lone parents with children aged 14 or over are required to attend; using mandatory action plans; and for all lone parents who have found a job through the New Deal for lone parents, **helping with childcare costs**;

- **continued reform of housing benefit**, beginning flat-rate Pathfinders in the social sector as soon as it is practical and aligning some of the rules of Housing Benefit and tax credits;

- improving work incentives in London by extending **pilots of a £40 per week in-work credit** to parents, including lone parents, who have been on certain benefits for a year or more;

- additional **help for those on benefits to enter self employment**;

- an **extension of eligibility for the enhanced New Deal for partners** to those in a family in receipt of the Working Tax Credit, who are either not working or are working less than 16 hours a week;

- an **extension of back to work help for those aged 60 or and on the Pension Credit** by October 2004 through improved access to the help available through existing employment programmes;

- **extra support for long-term sick and disabled people**, enabling Jobcentre Plus personal advisers to provide additional voluntary support to Incapacity Benefit customers who want to return to work; and

- **two additional Action Teams** to be introduced in Wear Valley and Barrow-in-Furness from April 2004.

BUILDING A FAIRER SOCIETY

The Government is committed to promoting fairness alongside flexibility and enterprise so that everyone can take advantage of opportunities to achieve their full potential in a modern, flexible economy. The Government is putting into practice the principle of progressive universalism, with support for all, and more help for those who need it most, when they need it most. This Pre-Budget Report sets out the next steps the Government is taking to support these aims, including:

- **increasing the child element of the Child Tax Credit** by £180 to £1,625 a year from April 2004, equivalent to a weekly increase of £3.50. As a result the Government is on track to meet or exceed its PSA target to reduce the number of children in low-income households by a quarter by 2004-05 on a before housing costs basis;

- **promoting the provision of employer supported childcare, with new measures to be implemented in April 2005**, as part of the Government's ongoing commitment to help people balance their work and family lives. Further details are available on the Inland Revenue website;

- consulting further on detailed **proposals to simplify the taxation of pensions** and **promoting the take up of the Pension Credit**, providing increased financial security for pensioners on low or modest incomes and helping to tackle pensioner poverty;

- bringing all **Sandler stakeholder medium-term and life insurance products into the stocks and shares component of ISAs** from 2005; and

- taking action to **protect direct and indirect tax revenues and modernise the tax system**.

In addition, the UK's work on implementing and enforcing UN financial sanctions has led to a transfer of £112 million to the Development Fund for Iraq. This contribution represents the frozen financial assets of the former Iraqi regime that were held in the UK.

The Government's second consultation document *Simplifying the taxation of pensions: The Government's proposals*, published alongside this Pre-Budget Report, sets out how the simplified regime would work if introduced, and proposes a number of modifications following the consultation.

In response to concerns expressed during the consultation so far, the Government will ask the National Audit Office (NAO) to consider, in light of the proposals set out in this document:

- whether it is factually accurate that the £1.4 million lifetime allowance is, using a factor of 20:1 to calculate the capital value of a defined benefit pension, equivalent to the maximum pension available under the current occupational pensions regime which includes the earnings cap;

- whether it is reasonable for the Government to estimate that around 5,000 people will have pension funds in excess of the £1.4 million at 5 April 2003; and

- whether it is reasonable for the Government to estimate that around 1,000 people a year may be affected by the lifetime allowance who would not have bee affected by the earnings cap.

The NAO will report in advance of Budget 2004, in order to allow an announcement to be made in the Budget on whether or not the Government will introduce the simplified regime. If it is decided to proceed, the measures will be in the 2004 Finance Bill and will be introduced in April 2005. Otherwise, the current eight different regimes will remain in place.

DELIVERING HIGH-QUALITY PUBLIC SERVICES

The Government's goal is to build a stronger, more flexible economy and a fairer society. World-class public services are crucial to achieving this goal. A healthy and educated workforce, modern and reliable transport network, and adequate supply of affordable housing promote productivity and flexibility and help to ensure opportunity and security for all. The Government's strategy is to deliver improvements in public services through sustained investment and reform to ensure that taxpayers receive value for money. The Pre-Budget Report describes how the Government is working to deliver reform of public services, through:

- **setting out the key issues which will guide the 2004 Spending Review**, which will lock in the step change in funding delivered in previous Spending Reviews. New resources will be rigorously targeted where they will have the greatest impact on delivery. The outcome of the Review will reflect a renewed focus on efficiency in the public sector; and

- **reporting on progress on the Reviews established in Budget 2003** to consider key issues in the run-up to the 2004 Spending Review, including the Lyons Review of public sector relocation, the Gershon review of public sector efficiency and the Devolved Decision Making Review.

PROTECTING THE ENVIRONMENT

Sustainable development is vital to ensure a better quality of life for everyone, today and for generations to come. Economic growth and social progress must be balanced with action to protect and improve the environment. The Government has made significant progress in using economic instruments to tackle environmental challenges. The Government believes that economic, social and environmental progress must go hand-in-hand, and policies should take account of the relationship between these different objectives. In order to develop the Government's environmental strategy, the Pre-Budget Report announces:

- the **establishment of an Alternative Fuels Framework** to guide the duty regime for alternative fuels; a gradual increase in the duty rate of Liquefied Petroleum Gas to a level which better reflects its relative environmental benefits; and a commitment to provide rolling three years' certainty on duty differentials for all alternative fuels;

- the extension, subject to state aid approval, **of relief from levy for aggregate used in Northern Ireland;**

- plans, subject to state aid approval, for extending the eligibility criteria for climate change agreements that will provide better **incentives for businesses to encourage energy efficiency**;

- **how the Government proposes to recycle landfill tax revenues to businesses**; and

- a consultation in early 2004 on **tackling diffuse water pollution**, including a consideration of the pros and cons of economic instruments.

NOTES FOR EDITORS

Further details of the Pre-Budget Report can be found on the Treasury's website: www.hm-treasury.gov.uk. More details are also included in the separate press notices listed below and available on the Treasury, Inland Revenue and HM Customs and Excise websites.

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HM Treasury	www.hm-treasury.gov.uk
Inland Revenue	www.inlandrevenue.gov.uk
HM Customs and Excise	www.hmce.gov.uk

PN 2

10 December 2003

INCOME TAX ALLOWANCES, NATIONAL INSURANCE CONTRIBUTIONS, AND CHILD AND WORKING TAX CREDIT RATES 2004-05

An increase of £180 per year in the child element of Child Tax Credit, to £1625 per child per year, equivalent to a weekly increase of £3.50, was announced by the Chancellor today.

As a result of this new investment, the Government is on track to meet or exceed its PSA target to reduce by a quarter the number of children in low-income households by 2004-05 on a Before Housing Costs basis.

3.7 million families and 7.2 million children will benefit from the increase in the child element of Child Tax Credit, approximately half of all families and children in the UK.

The Chancellor also announced that for pensioners, the personal allowance for those aged 65 or more will increase in line with earnings in April 2004:

- the personal allowance for people aged 65-74 for 2004-05 will increase in line with earnings to £6,830 – an increase of £220; and
- the personal allowance for people aged 75 or over for 2004-05 will increase in line with earnings to £6,950 - an increase of £230.

These changes ensure that no pensioner aged 65 or more will pay tax on income up to £131 per week.

The basic personal allowance for people aged under 65 will be increased in line with inflation to £4,745 for 2004-05. All other personal tax allowances, including the income limit for age related allowances, will increase in line with inflation.

The starting point for employers', employees' and self-employed National Insurance Contributions (NICs) in 2004-05 will increase in line with inflation to £91 per week. NICs are not paid on earnings or profits below this amount.

The upper earnings and profits limits for NICs will increase from April 2004 in line with inflation from £595 to £610 a week (£31,720 a year).

For the self-employed the rate of Class 2 contributions will be increased in line with inflation to £2.05 a week.

DETAILS

Child and Working Tax Credit rates and Child Benefit

Paymaster General, Dawn Primarolo today set out the Child and Working Tax Credit rates for 2004-05.

The Government had previously undertaken to uprate the child element of Child Tax Credit by earnings for the rest of this Parliament, which would have required an increase of £50 a year from April 2004. Instead it will be increased by £180 per year to £1,625 per year. In addition, the disabled child elements of Child Tax Credit will be uprated in line with inflation for 2004-05.

In line with the Government's commitment, the elements of the Working Tax Credit will also rise in line with inflation for 2004-05.

The rates of Child Benefit and Guardian's Allowance will rise in line with inflation for 2004-05.

The annex sets out the amounts of the elements, rates and thresholds for tax credits in 2004/05 and the rates of Child Benefit and Guardian's Allowance.

Draft statutory instruments, accompanied by the reports required under Section 41 of the Tax Credits Act 2002 will be laid before Parliament in due course.

Employers and employees

In line with the Social Security Contributions and Benefits Act 1992, the lower earnings limit for employees' Class 1 contributions is to be raised to £79 a week. It is set at the level of the basic retirement pension for a single person from April 2004, rounded down to the nearest pound. This is the lowest level of earnings that can count towards entitlement to contributory benefits.

The primary and secondary thresholds for Class 1 contributions will increase in line with inflation to £91 a week, the same as the weekly amount of the income tax personal allowance. This means that no tax or Class 1 contributions will be paid on earnings below this level by employees or employers.

The upper earnings limit for employees' Class 1 contributions will be raised to £610 a week, in line with inflation.

The standard main rate of employees' Class 1 contributions below the upper earnings limit will continue to be 11 per cent, and above the limit will continue to be 1 per cent.

The standard rate of employers' Class 1 contributions will continue to be 12.8 per cent.

The self-employed

The rate of Class 2 contributions will increase in line with inflation to £2.05 a week. Those with earnings below the annual small earnings exception can apply to be exempted from paying Class 2 contributions. This limit will be raised to £4,215.

The annual lower profits limit for Class 4 contributions will increase in line with inflation to £4,745. The self-employed will pay Class 4 contributions on all their profits above the lower profits limit of £4,745. The rate of Class 4 contributions will be 8 per cent on profits below the upper profits limit, and 1 per cent on profits above that limit. The upper profits limit for Class 4 contributions at the main rate of 8 per cent will be raised to £31,720 (in line with inflation), to maintain the link with employees' earnings liable to Class 1 contributions at the main rate.

Share fishermen

The special rate of Class 2 contributions for share fisherman, which allows them to build entitlement to contributory Jobseeker's Allowance in addition to the other contributory benefits available to the self-employed, will be increased in line with inflation to £2.70 per week.

Volunteer development workers

The special rate of Class 2 contributions for volunteer development workers, that entitles them to the full range of contributory benefits, will be increased by 10 pence to £3.95 in line with the statutory formula of 5 per cent of the primary Class 1 lower earnings limit.

Paying voluntary contributions

The rate of Class 3 voluntary contributions will be increased by 20 pence to £7.15 a week.

A draft re-rating order, accompanied by a report by the Government Actuary on the effect the order will have on the National Insurance Fund, will be laid before Parliament in due course.

The annex to this press notice sets out rates, earnings and profits limits, and thresholds for National Insurance contributions for 2004-05.

NOTES FOR EDITORS

Section 41 of the Tax Credits Act requires a report to be laid before Parliament each year reviewing the amounts of certain tax credit elements and thresholds. Section 145 of the Social Security Contributions and Benefits Act 1992 requires an annual review of Child Benefit rates. Section 150 of the Social Security Administration Act 1992 requires the weekly rate of Guardian's Allowance to be increased in line with prices.

Income tax allowances are uprated each year by indexation unless legislation is passed to override its effects. Statutory indexation for 2004-05 is based on changes to the Retail Prices Index in the year to September 2003 (2.8 per cent). A statutory instrument – The Income Tax (Indexation) (No. 2) Order 2003 - has been laid today, confirming the effect of indexation on the personal allowances, blind person's allowance, the married couples' allowances and the income limit for age related allowances for 2004-05. A measure will be included in the Finance Bill to increase the personal allowances for the over 65s by earnings.

Working and Child Tax Credits rates 2004-05

£ per year (unless stated)	2003-04	Change	2004-05
Working Tax Credit			
Basic element	1,525	(+45)	1,570
Couple and lone parent element	1,500	(+45)	1,545
30 hour element	620	(+20)	640
Disabled worker element	2,040	(+60)	2,100
Severe disability element	865	(+25)	890
Childcare element of the Working Tax Credit			
Maximum eligible cost for one child	135 per week	(+0)	135 per week
Maximum eligible cost for two or more children	200 per week	(+0)	200 per week
Per cent of eligible costs covered	70	(+0)	70
50+ Return to work payment (16-29 hours)	1,045	(+30)	1,075
50+ Return to work payment (30+ hours)	1,565	(+45)	1,610
Child Tax Credit			
Family element	545	(+0)	545
Family element, baby addition	545	(+0)	545
Child element	1445	(+180)	1,625
Disabled child element	2155	(+60)	2,215
Severely disabled child element	865	(+25)	890
Income thresholds and withdrawal rates			
First income threshold	5,060	(+0)	5,060
First withdrawal rate (per cent)	37	(+0)	37
Second income threshold	50,000	(+0)	50,000
Second withdrawal rate (per cent)	6.67	(+0)	6.67
First threshold for those entitled to Child Tax Credit only	13,230	(+250)	13,480
Income disregard	2,500	(+0)	2,500

Child Benefit/Guardian's Allowance rates 2004-05

£ per week	2003-04	Change	2004-05
Child Benefit			
Eldest/Only Child	16.05	(+0.45)	16.50
Other Children	10.75	(+0.30)	11.05
Eldest/Only Child (Lone Parent Rate)	17.55	(+0.00)	17.55
Guardian's Allowance	11.55	(+0.30)	11.85

Income Tax Personal and Age-related Allowances 2004-05

	2003-04	**Change**	**2004-05**
Personal allowance (age under 65)	£4,615	(+130)	£4,745
Personal allowance (age 65-74)	£6,610	(+220)	£6,830
Personal allowance (age 75 and over)	£6,720	(+230)	£6,950
Blind Person’s Allowance	£1,510	(+50)	£1,560
Married couple's allowance* (aged less than 75 and born before 6th April 1935)	£5,565	(+160)	£5,725
Married couple's allowance* (age 75 and over)	£5,635	(+160)	£5,795
Married couple's allowance* - minimum amount	£2,150	(+60)	£2,210
Income limit for age-related allowances	£18,300	(+600)	£18,900

* Married couple’s allowance is given at the rate of 10 per cent

National Insurance contributions 2004-05

	2004-05
Lower earnings limit, primary class 1	£79 per week
Upper earnings limit, primary class 1	£610 per week
Primary threshold	£91 per week
Secondary threshold	£91 per week
Employees’ primary class 1 rate	11% of £91.01 to £610 per week 1% above £610 per week
Employees’ contracted-out rebate	1.6%
Married women’s reduced rate	4.85% of £91.01 to £610 per week 1% above £610 per week
Employers’ secondary Class 1 rate	12.8% above £91 per week
Employers’ contracted-out rebate, salary-related schemes	3.5%
Employers’ contracted-out rebate, money-purchase schemes	1.0%
Class 2 rate	£2.05 per week
Class 2 small earnings exception	£4,215 per year
Special Class 2 rate for share fishermen	£2.70 per week
Special Class 2 rate for volunteer development workers	£3.95 per week
Class 3 rate	£7.15 per week
Class 4 lower profits limit	£4,745 per year
Class 4 upper profits limit	£31,720 per year
Class 4 rate	8% of £4,745 to £31,720 per year 1% above £31,720 per year

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PN 3

10 December 2003

PROTECTING AND IMPROVING THE ENVIRONMENT

A package of measures to reduce pollution and support energy efficiency in the UK was announced by the Chancellor today, which will help ensure that economic growth and social progress are balanced with action to protect and improve the environment.

> John Healey, the Economic Secretary to the Treasury said today:
>
> “This Pre-Budget Report is good news for the environment and good news for business. It will help deliver sustainable growth and a better quality of life for all. Our framework on green fuels puts the environment and business certainty at the heart of a coherent and radical policy on fuel duty discounts. Plans on the aggregates levy in Northern Ireland and reforms to the Climate Change Levy will increase the environmental gains from these schemes while increasing business competitiveness. At the EU level, the new Emissions Trading Scheme is going to be a huge step forward in tackling climate change across Europe.”

The Government is using a range of economic instruments to tackle the challenges faced in achieving sustainable development, tackling local environmental threats and controlling and reducing emissions of the gases responsible for climate change and poor air quality.

The PBR includes **key reforms on energy use** including:

- further steps to encourage **business energy efficiency** and reduce carbon emissions through extending the eligibility criteria for climate change agreements, which offer 80 per cent reductions from the climate change levy in return for negotiated environmental agreements;

- supporting the development of the **EU emissions trading scheme (EU ETS)**, by allowing those eligible for climate change agreements to retain the same incentives on entering into the EU ETS; and

- considering the responses to the recent consultation on economic instruments to **encourage more efficient use of energy in the domestic sector**.

The Government is working to **improve public and private transport**, including by:

- **publishing a proposed framework for the future taxation treatment of alternative fuels**, which sets out the principles of the Government’s approach to these fuels, putting the environment first and providing market stability for investors and consumers of alternative fuels;

- committing to **provide future market stability for alternative fuels**, with the Government announcing a three-year rolling commitment to the duty differentials between the main road fuels and all alternative fuels, with the relative rates to be announced in the Budget; and

- examining ways of focusing the duty regime on input-based as well as product-based taxation to **incentivise more environmentally and economically efficient types of biofuels manufacturing process**.

The Government's **waste strategy has been reinforced** with:

- **further improvements to the landfill tax credit scheme**, building on the work already under way, to increase choice through projects that conserve or promote biodiversity in natural habitats, streamline the scheme's administration to make it easier to manage and more straightforward for projects to apply for funding; and

- **the** announcement of further details about the **recycling of revenue from the landfill tax** increases to businesses, including a package of measures such as grants, advisory services and other financial support.

The PBR includes **measures to protect Britain's countryside and natural resources**, such as:

- consulting in early 2004 on **tackling diffuse water pollution**, including a consideration of the pros and cons of economic instruments; and

- extension of the relief from the aggregates levy currently available for aggregate used in processed products in Northern Ireland to cover both processed products containing aggregate and virgin aggregate from 1 April 2004 - subject to state aid approval and the industry in Northern Ireland agreeing to stringent environmental commitments. The relief will be fixed at 80 per cent of the full rate until 31 March 2012.

DETAILS

Alternative fuels framework

The Government today published its proposals for an alternative fuels framework, which sets out the tiered principles for policy decisions on these fuels. The statement of principles confirms that:

- policy must be both environmentally and economically sustainable; and
- the Government sees a significant role for alternative fuels and is keen to avoid an industry whose long-term survival is dependent on excessive levels of subsidy unjustified by environmental benefit.

In addition, the Government commits to a rolling three-year certainty period for duty differentials on alternative fuels.

Road fuel gases

Following consultation on future support for road fuel gases the Government has considered the evidence presented on the use of these fuels. In line with the principles set out in the proposed alternative fuels framework, the Government has decided that the environmental benefits offered by liquefied petroleum gas (LPG) no longer justify the level of duty differential it currently receives which is almost double the rate of any other EU country. Consistent with the environmental benefit and the new framework on alternative fuels, the rate for LPG will be gradually increased over time towards a level more commensurate with its environmental benefit.

The emissions evidence for natural gas (NG) vehicles suggests that they offer considerable additional benefits over conventional fuels, particularly on air quality. The Government has therefore decided that the duty differentials for NG will be held constant for a further three years.

EU emissions trading scheme

An EU-wide emissions trading scheme (EU ETS) is due to be introduced in 2005 and the arrangements for the scheme are set out in the EU Emissions Trading Directive. The EU ETS will allow UK participants to buy and sell carbon emissions across Europe with the aim of reducing emissions, in line with international and domestic targets, and taking account of business competitiveness issues. It will provide participants with a least-cost approach to reducing emissions, providing the opportunity to buy emissions savings from those who can afford to abate more cheaply. The Government will consult again shortly on what the National Allocation Plan might look like with the intention of submitting its final plan to the Commission by 31 March 2004.

Eligibility for climate change agreements

Following consultation with industry, and agreement on the new Energy Products Directive, the Government has decided that, subject to EU state aid approval, it will extend the eligibility criteria for climate change agreements (CCAs) during 2004. The existing criteria will remain but, in addition, the Government will consider CCAs for sectors that meet a specific energy-intensity threshold, and will look to take account of any competitive distortions in those sectors. Further consultation with industry will take place between the PBR and the Budget 2004 on what level the energy intensity threshold should be set, on competition issues and on minimising the administrative burden of such a system.

Household energy efficiency

The Government confirms its belief that there is a role for the use of economic instruments to encourage household energy efficiency, as part of the Government's wider policy programme to meet its Energy White Paper commitments. Taking into account the responses to the consultation document, and in light of the Corporation Tax Review and negotiations with EU partners on VAT reduced rates, the Government will give further consideration to measures to promote household energy efficiency, including the case for a domestic business tax allowance.

Landfill tax spending programme

Following a general consultation in the run up to Budget 2004, the Government will discuss with stakeholders the best specific mechanisms to deliver its commitment to recycle increases in landfill tax revenue to business, providing this support in the run-up to Budget 2004. It proposes a package of measures that is likely to include grants, extending promotional and capacity building services, enhanced capital allowances, interest-free loans and venture capital funding.

Extension of relief from the aggregates levy in Northern Ireland

Following discussions with stakeholders, and subject to state aid approval, the Government intends to extend the scope and length of the current relief for aggregates in Northern Ireland. The new relief will continue to cover aggregates in processed products and be extended to cover virgin aggregate, coming into effect during 2004 and fixed at the current level of 80 per cent of the full rate until 31 March 2012. However, only aggregates businesses that agree to implement stringent environmental improvements to their operations will benefit. The environmental improvements that quarry operators will need to sign up to will be regularly monitored and reviewed, and enforcement activity will be stepped up.

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PN 4

10 December 2003

SUPPORTING ENTERPRISE AND PRODUCTIVITY

Reforms to improve access to finance, encourage enterprise and investment in the economy and cut red tape were announced by the Chancellor today, benefiting over 670,000 businesses and entrepreneurs in the UK.

The Economic Secretary, John Healey said:

> "Enterprise and productivity is at the heart of this Government's agenda and is vital to a strong and successful economy. The 2003 Pre-Budget Report announces measures to stimulate an enterprise culture in all parts of the UK and ensure that British businesses flourish in the modern global economy. Improving access to finance, cutting red tape and reducing the burdens on business will allow UK firms to make the most of a stable and successful economy."

The Government is committed to developing a strong enterprise culture in the UK, ensuring that anyone with the talent, potential and drive to succeed can do so. Following the consultation launched alongside Budget 2003, the Government today sets out further measures to help small businesses raise finance in *Bridging the finance gap: next steps in improving growth capital for small business*. In it the Government announces:

- the launch in **spring 2004 of a first round of Enterprise Capital Funds**, based on the US Small Business Investment Companies model;

- **proposals to improve Venture Capital Trusts (VCTs) and the Enterprise Investment Scheme** to make them more attractive to investors, including a **temporary stimulus to VCT fundraising** in light of recent market weakness;

- an independent **review of the effectiveness of the Small Firms Loan Guarantee** to ensure that small firms seeking debt finance get the help that they need; and

- a package of measures to ensure that small businesses can **access the knowledge and advice they need to benefit from the financing options available**.

To encourage **innovation, investment and skills** the Pre-Budget Report sets out the following:

- **changes to the R&D tax credits** schemes to give companies effective, targeted support for research and development while reducing their compliance costs, giving business additional certainty and making decisions easier;

- an **increase in the small and medium sized company thresholds** to the maximum permitted under EU law, doubling the amount of investment qualifying for the 40 per cent plant and machinery first year allowances and **providing a cash flow boost to smaller businesses of almost £400 million over the next 3 years**;

- a discussion paper on **the tax treatment of fees and subscriptions to professional and other approved bodies**, to establish the scope for this system to make a greater contribution to the wider training and skills agenda;

- the extension of **Employer Training Pilots to encourage skills training for a third year** and to cover over a third of England; and

- measures to **improve the efficiency and flexibility of the property investment market**.

The Government is committed to an enterprise economy and promoting productivity. To **reduce the burdens on business and cut red tape**, the Pre-Budget Report announces:

- **improvements to the VAT flat rate scheme,** including new lower rates and easier administration to make the scheme more attractive to the 672,000 eligible businesses and tailoring the scheme to recognise the demands of VAT on newly registered small business;

- help and advice for businesses through the launch of **the *businesslink.gov.uk* website** in April 2004, providing a one-stop shop for business support and making regulatory obligations easier to understand;

- action to ensure that where regulations are necessary, they are **comprehensible and simple**, such as introducing “see at a glance” guidance for all new regulations to reduce the time that entrepreneurs spend establishing whether a regulation applies to them; and streamlining employment tribunal procedures, in line with a consultation launched last week;

- building on the Budget 500, the Government is today publishing a **revised Regulatory Reform Action Plan**, which takes the total number of deregulatory measures identified to over 650, of which over a third have already been delivered;

- measures to ensure **stability and certainty** in the regulatory environment, for example the Government will now consider extending the common commencement dates pilot for employment regulation to other areas of regulation, where appropriate;

- a new **Construction Industry Scheme from April 2006**, reducing the regulatory burden on the industry, improving compliance and helping it to get the status of its workers right; and

- an independent **review of UK businesses' experiences of accessing public contracts in Europe** by Alan Wood, Chair of the Economic Policy Committee of the Engineering Employers Federation, and CEO of Siemens in the UK. The review will report back in summer 2004 on how to improve the ability of UK firms to compete effectively for public procurement contracts in other EU countries.

The Pre-Budget Report announces steps to promote the **development of an enterprise culture** across the UK:

- **supporting a national campaign by Enterprise Insight** to create a step change in the enterprise culture among young people in the UK;

- providing opportunities for selected participants in the New Entrepreneur Scholarship scheme to **spend a term at a US business school**; and

- setting up a forum for US and UK practitioners and policy makers **to share best practice** on enterprise education, work related learning and professional development for teachers.

The Government is committed to **raising productivity across all regions of the UK**. The Pre-Budget Report also includes specific measures targeted on promoting productivity, including:

- decisions on the mechanism for a scheme to **reward local authorities for supporting economic growth** in their area by allowing them **to retain a**

proportion of increases in local business rate revenues to spend on their own priorities, to be finalised in Budget 2004; and

- subject to state aid approval, a scheme to provide **100 per cent capital allowances for the capital costs of renovating business premises** vacant for a year or more in the 2,000 Enterprise Areas.

DETAILS

Reforms to research & development tax credits

The definition of R&D for tax purposes is being simplified. A draft new definition is being published today and the views of business will be sought before it comes into force. This clearer definition will reduce companies' compliance costs by making it easier for them to decide at the outset whether their activities will qualify for the credit. The definition of qualifying costs is also being clarified and widened to include materials consumed, software, water and fuel used directly in the R&D. In addition, the Government will continue discussions with business to understand whether any direct costs are outside the currently proposed change and how any such costs might be brought within the schemes while minimising compliance burdens and cost effectively supporting R&D. The Government will introduce changes to ensure the credit is available where large companies subcontract to non-corporation tax chargeable entities and will make minor changes to ensure that staff costs for benefits in kind do not qualify for the credit. The Government response to *Defining Innovation*, the consultation document published in the summer can be found on the Inland Revenue website.

Access to finance

Bridging the finance gap: next steps in improving growth capital for small business, published alongside the Pre-Budget Report today, sets out the Government's intention to take forward a pathfinder round of Enterprise Capital Funds (ECF), which will adapt the US Small Business Investment Company model and inform any decision about the scope for a long term ECF programme.

The paper sets out proposals to remove, from 6 April 2004, the current capital gains tax deferral relief for investments in Venture Capital Trusts (VCTs) and replace it with an enhancement, of equivalent value, to the incentives to invest through income tax relief. In light of the recent relative weakness of the VCT market, the paper also sets out proposals to provide a temporary stimulus to VCT fundraising for a period of two years. The Government's favoured option is a temporary increase in the value of income tax relief from 20 per cent to 40 per cent, with the value of the additional 20 per cent paid directly to the VCT rather than the investor. Subject to discussion with the industry, the Government also intends to increase to £200,000 from 6 April 2004, both the annual investment limit for VCTs and the threshold for income tax benefits under EIS.

The Government also announces that it has asked Teresa Graham, a member of the Small Business Council, to undertake an independent review of the Small Firms Loan Guarantee to ensure that, in light of a changing debt market, small businesses continue to receive the support that they need to overcome barriers to raising debt finance. Because the demand for finance by businesses is as important as ensuring its supply, the paper also sets out a package of measures to promote knowledge and awareness among small businesses of the financing options available to them.

VAT flat rate scheme

The flat rate scheme was introduced in April 2002 and offers significant compliance cost savings for the smallest businesses by reducing their record-keeping requirements and simplifying the calculation of VAT due. Following a review of the scheme, improvements announced today and coming into effect on 1 January 2004 will include further simplification of the administration of the scheme to enable more businesses to benefit from overall compliance savings, new lower rates and recognising the particular demands of VAT on new business, a discounted rate of 1 per cent below the normal rates for newly-registered small businesses. The new rates will range from 2 to 13.5 per cent (1 to 12.5 per cent for newly-registered businesses), compared to existing rates of 5 to 14.5 per cent.

Construction Industry Scheme

The Chancellor announced in Budget 2003 that a new Construction Industry Scheme would be introduced in April 2005. This scheme has been developed in detailed discussions with the industry, who have expressed concern that the April 2005 start date would leave it insufficient time to prepare properly for the change. The Government therefore decided that, in order to ensure a smooth and orderly transition to the new scheme, implementation will be deferred until April 2006. The Government plans to include the necessary legislation in Finance Bill 2004. Further details can be found in PN6 Protecting Revenues press notice.

Small and medium-sized company thresholds

The Companies Act 1985 defines a company as a small or medium sized company for its first financial year if it meets two of more of the following requirements in that financial year. Once a company has qualified as a small or medium sized company it will continue to be a small or medium sized company unless it fails to meet two or more of the requirements for two years in a row. Where a large company reduces in size, to become a small or medium sized company it must meet two or more of the requirements for two successive years:

	Turnover (not more than)	Balance sheet total (not more than)	Number of employees (not more than)
Small	£2.8 million	£1.4 million	50
Medium	£11.2 million	£5.6 million	250

The DTI will be laying regulations shortly and it is expected that they will come into force in January 2004. The following increased thresholds will replace those above for accounting periods ending on or after the date the regulations come into force:

	Turnover (not more than)	Balance sheet total (not more than)	Number of employees (not more than)
Small	£5.6 million	£2.8 million	50
Medium	£22.8 million	£11.4 million	250

Employer Training Pilots

Employer Training Pilots (ETPs) were introduced in six local Learning and Skills Council (LSC) areas in September 2002 to test new measures to improve access to training. ETPs offer a package of support to help low-skilled people in work gain basic skills or their first level 2 qualification. Employers that offer their low-skilled staff paid time off to train are provided with compensation for wage costs (varying according to pilot area and size of firm). Training is free or heavily subsidised, and is delivered in the way that most suits the employers' businesses. Both employees and employers are offered free information, advice and guidance. The pilots were extended for a further year and doubled to cover six new areas in the 2002 Pre-Budget Report.

An independent evaluation of the first year of the pilots was published on 4 December 2003. The evaluation showed that ETPs are proving successful at engaging employers and their low-skilled employees in training. At the end of the first year, over 3,000 employers and 14,000 employees were involved in the scheme. Over 70 per cent of employers taking part had fewer than 50 employees and 40 per cent had no previous contact with a government agency – suggesting that ETPs are reaching workplaces where training has not been a high priority in the past.

Building on the success of this programme, the Government is now extending ETPs for a third year. ETPs will launch in six further local LSC areas, bringing the total to 18 – a third of England. This will enable the Government to explore further the impact of the existing pilots on the demand for training.

Property Investment

A consultation will be published at Budget 2004 to consider the most appropriate structure and conversion charge for a tax transparent property investment trust, alongside the taxation of related property investment products. Following informal discussion with industry, the Government has also today published draft legislation showing how a model for the taxation of property derivatives might operate. This will also be of interest to those using or advising on the use of equity derivatives for investment purposes.

Renovation of business premises

The Government is currently discussing the State Aid implications of an allowance to help with the renovation of business premises in Enterprise Areas, which have been vacant for a year or more. Subject to state aid approval the Government aims to introduce the allowance in 2005; further details will be published at the Budget.

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PN 5

10 December 2003

A COMPETITIVE AND MODERN BUSINESS TAX SYSTEM

A package of measures to strengthen the UK's competitive business tax regime, was announced by the Chancellor today. The measures, which promote investment, growth and fairness, will build a tax system that recognises the realities of the modern business world.

The Paymaster General, Dawn Primarolo, said:

> "The measures announced today will ensure that the UK has a fair and competitive tax system that recognises the challenges of today's business environment. They will advance the Government's vision of a modern and efficient tax system that supports commercial decisions and promotes economic efficiency and productivity while keeping pace with European and international developments."

The Government is considering the issues raised in response to the August 2003 consultation on corporation tax reform and looks forward to continuing the dialogue with business. Two measures have been identified as priorities for reform, and are announced today:

- the **extension of relief for the expense of managing investments** to companies that do not qualify as investment companies, removing outdated and unnecessary restrictions that currently cause some companies to adopt uncommercial structures in order to obtain relief; and

- reform of the **transfer pricing and thin capitalisation** rules and a package of measures to mitigate the impact of the extension of the current rules particularly for smaller businesses.

To promote investment and simplify the tax system, the Pre-Budget Report announces:

- **changes to the tax rules for offshore** funds to enable a wider range of investments in offshore funds to meet the rules for "distributor" status;

- measures to ensure that companies choosing to adopt International Accounting Standards (IAS) to draw up their accounts receive broadly equivalent tax treatment to companies that continue to use UK GAAP (UK Generally Accepted Accounting Practice);

- publication of **draft amendments to the legislation on the taxation of corporate debt** to assist companies in administration, administrative receivership, and liquidation; and venture capital funds investing in close companies;

- **implementation of the Interest and Royalties Directive** from 1 January 2004, removing source state taxation of payments made between associated companies in the EU and a consultation on introducing a definition of 'UK source' for the purposes of deducting tax from payments of interest and royalties;

- the introduction of **an exploration expenditure supplement** so that the full value of the 100 per cent exploration and appraisal allowance for new North Sea companies is maintained over time; and

- changes to facilitate the **introduction of the European Company Statute** which comes into effect from 8 October 2004.

DETAILS

Corporation tax reform – relief for the expense of managing investments

The Government will extend corporation tax relief for the expenses of managing investments by lifting the requirement to qualify as an investment company from 1 April 2004. This measure was widely welcomed in the Corporation Tax Reform consultation. This will benefit companies by:

- removing an outdated restriction that creates difficulties for some groups. Up to now, many groups have had to introduce extra companies in order to create investment companies that do not themselves have trades. This layer of complexity will be removed; and

- facilitating group re-structurings, which may be desirable for commercial reasons and may help to reduce the administrative impact of the transfer pricing changes.

Corporation tax reform – transfer pricing and thin capitalisation

Transfer pricing and thin capitalisation rules exist to ensure a fair division of profits between related entities. The transfer pricing rules require transactions between related enterprises, such as companies within the same group, to be priced as if they had been between enterprises dealing at arm's length. If a transaction would not have taken place at all between unrelated enterprises, then it can be treated for tax purposes as if it had not occurred. The thin capitalisation rules deny a tax deduction for excessive interest payments between certain related parties.

The UK’s transfer pricing and thin capitalisation legislation generally only apply where one party to a transaction is outside the UK. Some doubts have been expressed as to the interaction of these rules with European law. While the Government does not accept that there is any incompatibility, it recognises the importance for business of certainty in tax law. The measures announced today will remove any uncertainty by extending the scope of transfer pricing rules to transactions within the UK from 1 April 2004. The thin capitalisation legislation will be repealed, and the transfer pricing rules will be adapted to enable them to undertake the same role.

This change would, if made in isolation, increase administrative burdens. Therefore the Government is implementing measures to mitigate the effect, including:

- an exemption for small and medium sized businesses to ensure that over 95 per cent of businesses do not have to worry about transfer pricing when making a tax return;
- to protect tax revenue, the rules will be retained for transactions with certain overseas territories and, for medium sized businesses, the Inland Revenue will retain a reserve power to apply the rules in exceptional cases justified by significant tax at risk;
- a relaxation of the penalty regime for a transitional period of two years to give businesses time to adjust to the new rules;
- steps to ensure that the new rules will not result in double taxation. Every adjustment to the taxable profits of one party to a transaction will be matched by a compensating adjustment for the other party, to ensure that both are taxed on a consistent basis. Special rules for loan guarantees and accrued interest will ensure that normal commercial lending arrangements will not be disturbed by the extension of the transfer pricing regime; and

- new guidance on both the Inland Revenue's risk-assessment strategy and on documentation requirements, helping business to reduce the cost of tax compliance and the documentation that they need to keep to comply with transfer pricing rules.

Draft legislation and a summary of responses to the consultation on the management expenses and transfer pricing changes can be found on the Inland Revenue website.

Offshore Funds Reform

The Government intends to introduce changes in the 2004 Finance Bill to the taxation rules for offshore funds. These will amend the rules that determine whether investments in offshore funds can be treated as investments in "distributing" funds, so that UK resident investors in offshore funds will, in a wider range of circumstances, be charged to tax in the same way as an investor in an equivalent UK fund.

Tax and accounting (IAS and UK GAAP)

The Inland Revenue is continuing to work with consultative groups to look at the detail of IAS and of complementary changes to UK GAAP that will apply in 2005. As a result of work done so far legislation will be introduced to:

- ensure that accounts prepared in accordance with either IAS or UK GAAP will be an acceptable starting point for computing taxable profits;

- ensure the R&D tax rules continue to allow the special reliefs and credits in the year in which expenditure is incurred, whatever the accounting treatment;

- continue the current tax treatment of most hedging arrangements using derivative contracts and foreign currency liabilities; and

- amend the corporate debt and derivative contracts legislation to reflect the changes made by IAS 39 and complementary revisions to UK Accounting Standards.

North Sea exploration

Budget 2003 launched a consultation to examine the reasons behind current low levels of oil and gas exploration, such as the concerns of some companies that they will not be able to gain access to infrastructure on appropriate terms and the need to continue to free up certain licensed acreage. To encourage exploration and appraisal activity by companies new to the North Sea the Government will introduce an exploration expenditure supplement. The supplement will ensure that the full economic value of the current 100 per cent allowance is maintained over time Full details will be announced at Budget 2004.

European Company Statute

The European Company Statute is an EU Regulation which permits the setting up of a new kind of corporate entity, the European Company or Societas Europaea (SE). The SE is a legal vehicle for entities with a presence in more than one EU member state. Although the Regulation does not mention tax, some technical tax changes may be necessary to facilitate the formation of SEs and to make sure the UK is an attractive environment for SEs to set up.

The Inland Revenue is currently following in the steps of the DTI consultation on the UK company law changes required by the Regulation. The Government will publish draft clauses in the New Year to enable the European Company Statute to be accommodated within UK tax law, with a view to including the necessary legislation in Finance Bill 2004.

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PN 6

10 December 2003

TACKLING TAX AVOIDANCE

A series of measures to protect tax revenues from fraud, evasion and avoidance were outlined in the Pre-Budget Report today.

Paymaster General Dawn Primarolo said:

> "The measures announced today demonstrate the Government's determination to tackle tax avoidance and create a fair environment for all."

DETAILS

Trusts

From 6 April 2004 the tax rate paid on the income and capital gains of trusts will increase from 34 per cent to 40 per cent (and the corresponding dividend trust rate from 25 per cent to 32½ per cent). This removes a distortion that provides avoidance opportunities for some higher rate taxpayers, but will not affect the position of tax payers not liable at the higher rate who receive income from a trust, who will continue to be able to reclaim any excess income tax paid by the trustees on their behalf.

In order to reduce compliance burdens for small trusts, the Government will be consulting on a modernised income and capital gains tax regime for trusts. In particular the Government will aim to reduce the tax burdens on smaller trusts and to ensure that trusts established to protect the vulnerable are not disadvantaged by the tax system. The Inland Revenue will publish details of the modernisation proposals tomorrow.

With immediate effect, the capital gains "gifts relief" legislation will be amended to counter tax avoidance schemes that involve the transfer of assets into a trust. Draft clauses for this change are being published today on the Inland Revenue website together with draft Explanatory Notes. This legislation will be included in Finance Bill 2004.

Action will also be taken against avoidance of the Inheritance Tax rules for Gifts with Reservation, where the former owner continues to enjoy the benefits of ownership of an asset. Finance Bill 2004 will legislate to impose a charge on the benefit gained from using the asset, following consultation on the detailed workings of this measure.

Construction industry

The Inland Revenue is increasing compliance activities in the Construction sector to ensure that everyone understands and meets their tax obligations. To tackle non-compliance in the construction industry by contractors routinely ignoring their responsibilities both as contractors and employers, and by sub-contractors using artificial schemes. As part of the reform of the Construction Industry Scheme, there will be a new employment status declaration for contractors, and the Inland Revenue will be increasing its compliance activities in this sector to ensure that all involved understand and meet their tax obligations.

Film Tax Relief

Film Tax Relief has encouraged a substantial amount of investment in UK films, much of which occurs because the investors enjoy immediate tax relief on the purchase or production of the film with the expectation that they will pay tax on income received from the film in subsequent years. However, the tax avoidance industry has marketed schemes to allow investors to convert the tax deferral into a permanent tax advantage. From today, where an investor exits from a film business in a way that gives rise to an unwarranted tax advantage, they will be subject to a charge that will remove the advantage. Details of the proposed legislation are published on the Inland Revenue website.

Payments to employees by third parties connected to the employer

The law will be clarified in cases where connected third parties, such as companies in the same group as the employer, make payments to employees. Regulations will be laid before Parliament shortly to ensure these payments cannot be treated as gratuities exempt from National Insurance Contributions. These changes will not affect tips paid to waiters and others in similar employment.

Foreign Earnings Deduction (FED) for Seafarers

The FED provides a 100 per cent tax relief to encourage UK seafarers to work on UK deepwater vessels, which could be called upon in times of conflict. However, the relief is currently being exploited by some oil and gas workers on offshore installations around the world, to receive a tax relief that was never intended for them. Steps will be taken to make clear that employees working on offshore installations are not entitled to claim this relief. This will take effect from 6 April 2004.

Gift Aid relief

Improvements to the Gift Aid scheme introduced in Budget 2000 have had the unintended effect of widening the impact of the special statutory exemption available to some heritage and conservation charities. As a result, these charities have introduced schemes that grant free day admission in return for a donation that attracts Gift Aid. The Government is determined to maintain the integrity of the Gift Aid scheme and intends to take steps to close this loophole in the legislation in Finance Bill 2004. The details of the measure will be discussed with the charities concerned.

VAT on assigned debts

The Government is introducing new rules to prevent VAT avoidance on debts assigned by companies to connected businesses, protecting some £20 million VAT a year. Businesses that are not paid by their customers for goods and services are able to claim from Customs the VAT they charged, but have been unable to collect. Normally the VAT is repaid to Customs if the business subsequently receives payment from its customer, but this does not apply where the debt has been assigned to another business.

Legislation effective from 11 December prevents an avoidance scheme where businesses assign debts to connected businesses in order to retain any VAT subsequently paid to them.

VAT: abusive grouping

A paper *Tackling VAT group abuses* will be issued shortly, setting out proposals for a new legislative definition of eligibility to join a VAT group, based on accounting standards for consolidating subsidiaries in group accounts. The new criteria will focus on the realities of control and economic benefit to determine whether VAT grouping should be allowed. As well as providing greater certainty to taxpayers, the new rules will help tackle abuses of VAT groups through artificially contrived grouping arrangements.

Partial exemption

Partly exempt businesses (which make both taxable and VAT exempt supplies) may use either a standard method or a bespoke method to calculate the VAT that they are entitled to reclaim from Customs. Where a bespoke method gives an unfair or over-generous result, Customs cannot terminate that method unless they have already prepared a fairer method or negotiated one with the business.

Legislation, to take effect from 1 January 2004, will allow Customs to set an effective date from which they can correct the effects of unfair methods. This will help to ensure that sensible negotiations of new, fairer methods take place in a timely manner, helping to prevent losses of some £50 million a year under the current rules caused by deliberate delays in reaching such agreements, in a way that will not affect compliant businesses.

Tackling VAT losses

The Government is extending the VAT strategy launched last year, with a further 450 staff to be deployed over the next two years, in particular to improve assurance activity and recover debts from wilfully non-compliant businesses. *Protecting Indirect*

Tax Revenues, published alongside the 2002 Pre-Budget Report, set out the Government's strategic approach to measuring and reducing indirect tax losses as a result of fraud, smuggling and other non-compliance. The VAT strategy aimed to reduce losses by £2 billion a year by 2005-06. The Pre-Budget Report announces a further 450 Customs staff to be deployed over the next two years, to increase assurance activity and improve collection of unpaid debts. Additional specialist staff will also help to ensure that areas presenting significant revenue risks are identified and addressed earlier. The extension to the package is expected to produce an additional £185 million in 2004-05, rising to £315 million in 2006-07. Further details and updates on the strategic approach can be found in *Measuring and tackling indirect tax losses* on the Customs website.

Alcohol strategy

Alongside the strategies for tackling VAT, tobacco and oils fraud, the PBR now launches the first comprehensive strategy to tackle alcohol fraud:

- introducing new controls for better regulation of the alcohol regime during 2004;

- making preparations for the implementation of the Roques report recommendation to apply tax stamps to bottles of spirits to aid identification of illicit spirits currently being sold to unwitting customers in ordinary retail outlets at normal prices, despite not having tax paid on them; and

- setting HM Customs & Excise a target to reduce substantially the illicit share of the spirits market.

The Government plans to bring forward legislation for the tax stamps proposal in Finance Bill 2004. However, it will also consider any new proposals the spirits industry wishes to put forward in the coming months for alternative measures that would be as effective in tackling spirits fraud as tax stamps. Although the Government believes tax stamps constitute a necessary response to the problem of organised spirits fraud, it will also consider options for mitigating increased costs to the legitimate trade if tax stamps are implemented.

Details of the new regulatory controls, and of the invitation for alternative proposals to tax stamps, are set out in a Customs business brief published today, available at the Customs website. Plans for the implementation of tax stamps and draft legislation for the 2004 Finance Bill will be published in spring 2004, along with a draft Regulatory Impact Assessment. Details of the new target for HM Customs & Excise will be announced when setting PSA targets as part of the 2004 Spending Review.

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