

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 reforms of the welfare state introduced by this Government reflect its aims of tackling child and pensioner poverty, promoting saving and ensuring security for all in old age. The Government is also committed to a modern and fair tax system which encourages work and saving and ensures that everyone pays their fair share of tax. 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.** This will benefit 7.2 million children and means that the Government is on track to meet or exceed the target to reduce the number of children in low-income households by a quarter by 2004-05 on a before housing costs basis. The increase will enable the Government step by step to make progress towards its goal to halve child poverty by 2010 and eradicate it in a generation;
- **promoting the provision of employer supported childcare,** as part of the Government's ongoing commitment to help parents balance their work and family lives;
- **consulting further on detailed proposals to simplify radically the taxation of pensions,** increasing choice and flexibility for pension savers and promoting the take up of the Pension Credit, launched in October 2003, providing increased financial security for pensioners on low or modest incomes and helping to tackle pensioner poverty;
- **bringing all Sandler Stakeholder medium-term products 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.**

INTRODUCTION

5.1 Previous chapters have described the Government's strategy for delivering strong and stable growth, through a robust macroeconomic framework and reforms which promote an enterprising and flexible economy with high levels of employment. This chapter describes how the Government is working to extend opportunity and security across the economy. The Government is committed to ensuring flexibility and fairness are advanced together so that everyone can take advantage of opportunities to achieve their full potential in a modern, dynamic economy. This chapter details action to tackle child and pensioner poverty, promote saving and ensure security for all in old age. The chapter also describes the action the Government is taking to promote a modern and fair tax system and to achieve the Millennium Development Goals to reduce global poverty.

5.2 The principles which underpin the welfare state are those of opportunity, responsibility and security. Chapter 4 describes how the Government's goal of ensuring employment opportunity for all is central to avoiding poverty during working life and provides the best platform from which to save for security in retirement. This chapter describes the action the Government is taking to put 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.

5.3 Measures described in this Pre-Budget Report build upon the significant welfare reforms of recent years. A new external report from the Joseph Rowntree Foundation and the New Policy Institute highlighted the fact that income poverty in Britain is on a steady downward trend from a figure of around 13.4 million in the mid-1990s to 12.5 million people in relative low-income households in 2001-02. It is now lower than at any time in the 1990s, an indication of real and tangible progress. Making opportunity a reality requires a modern and fair tax and benefit system which offers real choice and acknowledges that people's lives have changed since Beveridge's reforms in the 1940s. Recent measures to expand choice include, for example:

- extending maternity leave and pay and introducing paid paternity leave to enable working parents to spend more time with their new babies;
- increasing the supply of childcare and providing greater support for childcare costs for working parents; and
- allowing people deferring their basic state pension to take a more generous pension or a lump sum.

SUPPORT FOR FAMILIES AND CHILDREN

Tackling child poverty

5.4 The Government believes that economic strength should be underpinned by fairness and social inclusion. All children should have the chance to fulfil their potential and take full advantage of the opportunities available to them, regardless of circumstances. Starting life in poverty can entail wide-ranging and long-term disadvantage, often passed on from one generation to the next.

5.5 In the mid to late 1990s, the UK suffered higher child poverty than nearly all other industrialised nations.¹ Over 20 years, the proportion of children living in relative low-income households had more than doubled. The Government therefore set an ambitious long-term goal to halve child poverty by 2010 and to eradicate it by 2020.

5.6 The Government's strategy for tackling child poverty involves ensuring decent family incomes, with work for those who can and support for those who cannot, and providing support for parents. It also involves delivering high quality public services and harnessing the power and expertise of the voluntary and community sectors.

Progress to date

5.7 As a first step towards eradicating child poverty, the Government is committed to a Public Service Agreement (PSA) target for 2004-05 to reduce by one quarter the number of children in low-income households² compared with 1998-99. The most recent data show that between 1998-99 and 2001-02 the numbers of children in low-income households fell by 0.4 million after housing costs (AHC) and by 0.5 million before housing costs (BHC), from 4.2 million and 3.1 million respectively.³ The Government has therefore succeeded in arresting and reversing the long-term trend of rising child poverty and is making steady progress towards the 2004-05 PSA target. These data do not reflect the effect of increased support from the introduction of the new tax credits in April 2003.

5.8 The Institute for Fiscal Studies (IFS) has recently estimated⁴ that, after allowing for this and the existing commitment to uprate the Child Tax Credit, there remains a need to lift

¹ *The dynamics of child poverty in industrialised countries*, Bradbury et al. (eds) 2001. Unicef, Cambridge University Press.

² Defined as those with less than 60 per cent of contemporary median income. Income is defined as household disposable income, adjusted for household size and composition.

³ Data from *Households Below Average Income 1994-95 to 2001-02*, Department for Work and Pensions, March 2003.

Income is measured on before housing costs and after housing costs bases to take into account variations in housing costs that themselves do not correspond to comparable variations in the quality of housing.

⁴ *What do the child poverty targets mean for the Child Tax Credit? An update*. M. Brewer, Institute for Fiscal Studies, Briefing Note No. 41, December 2003.

a further 0.2 million children over the threshold in 2004-05 at a cost of £1 billion. There is an inevitable uncertainty over such estimates; as the IFS acknowledge the Government could lift 0.2 million children over the threshold and still miss the target.

5.9 The reduction in the proportion of children in low-income households is particularly notable as it has been achieved during a period of high growth in household incomes. Between 1998-99 and 2001-02 average annual real median income growth was nearly 4 per cent BHC and nearly 5 per cent AHC. This income growth reflects the wider success of a range of Government economic policies, but it means that progress against a purely relative measure of poverty is particularly difficult.

5.10 This is underlined by the substantial progress made against an absolute low-income measure. Between 1998-99 and 2001-02, the number of children in absolute low-income households fell from 2.8 million to 1.6 million BHC, and from 4.0 million to 2.5 million AHC.

5.11 Subsequent sections of this chapter highlight the Government's policies to tackle child poverty, new investment to help meet the 2004-05 PSA target and next steps for the longer term.

Financial support for children

5.12 The Government's financial support for children is based on the principle of progressive universalism, with help for all families and more help for those who need it most, when they need it most. This support is delivered through the combination of universal Child Benefit and the progressive Child Tax Credit (CTC). The CTC includes a family element available to 90 per cent of families with children, with an income of up to £58,000 a year, and a child element for each child in a low-income household, plus additional help for families with a baby or a disabled child.

5.13 By 2003-04, financial support for children through tax credits, Child Benefit and other benefits had been increased by £9.2 billion in real terms from its 1997 level, a rise of 64 per cent. The extra investment has funded improved financial help for all families through Child Benefit, along with extra help for children in poor families and children with disabilities. The financial support available to a low-income family for a young child has more than doubled in real terms since 1997 and the additional help to which a family with a disabled child is entitled has risen by 70 per cent.

Child Benefit 5.14 Child Benefit is currently £16.05 a week for the first child in every family and £10.75 a week for subsequent children. From April 2004, the rates of Child Benefit will rise in line with the Retail Prices Index (RPI) to £16.50 and £11.05 respectively. The rate for the first child therefore remains 25 per cent higher in real terms than it was in 1997.

Child and Working Tax Credit 5.15 The Child and Working Tax Credits introduced in April 2003 represent the biggest single change in the way government provides financial support for families since the Beveridge reforms of the 1940s. The tax credits:

- provide support for children which is independent of the work status of their parents, bridging the gap between welfare and work;
- pay support for children to the main carer, transferring approximately £2 billion to mothers;
- are more generous, providing financial support to 5.9 million families, so avoiding stigma for poorer families;

- target resources effectively on families with the greatest needs and are responsive to family circumstances, so families receive greatest support when they need it most;
- are based on annual family income, which is both fairer and easier to verify than income measured over a short period, as was the case with Working Families' Tax Credit (WFTC); and
- improve incentives to save and to work, especially for second earners, and provide families with greater flexibility and choice.

Child Tax Credit 5.16 Whether in or out of work, the CTC provides a single, seamless system of income-related support for families with children, replacing and improving upon the child elements of the WFTC and the Disabled Person's Tax Credits (DPTC) and the Children's Tax Credit. For 2003-04, families on Income Support or Jobseeker's Allowance are benefiting from the increased support in tax credits through the child allowances in their benefits and these families will be migrated onto tax credits during 2004-05.

5.17 Paid on top of universal Child Benefit, the CTC comprises:

- a family element of £545 a year – doubled to £1,090 for families with a child under the age of one – for all families with incomes of less than £50,000, gradually withdrawn for those with incomes above this amount;
- a child element for each child or young person in low-income families, gradually withdrawn for families with higher incomes; and
- increased child elements to reflect the greater needs of families caring for disabled children.

5.18 By October 2003, 10.5 million children were benefiting from the CTC. Compared with 1.4 million working families who benefited from the WFTC or the DPTC, 2.25 million working families were receiving support above the family element. The additional help available was also reaching more families with a disabled child and those with childcare costs. Further details of the support provided by the Working Tax Credit (WTC) are provided in Chapter 4.

New investment to help meet child poverty target 5.19 Building upon the introduction of the CTC, this Pre-Budget Report announces that the **child element will increase from April 2004 by £180 to £1,625 a year, equivalent to a weekly increase of £3.50**. This increase will benefit 7.2 million children in 3.7 million families. The disabled child elements of the CTC will increase in line with RPI.

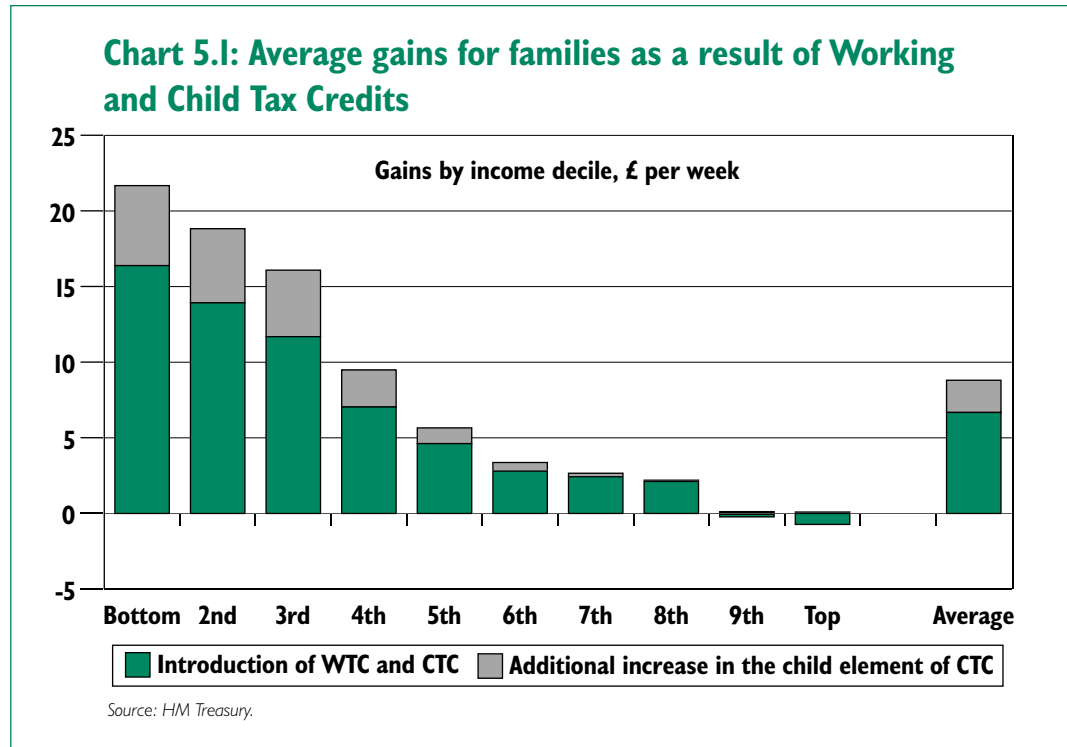
5.20 As a result of this new investment, the Government is on track to meet or exceed its PSA target to reduce by a quarter the number of children in low-income households by 2004-05 on a BHC basis, comparable to the European child poverty indicator. The target is more challenging on an AHC basis. The nature of the target means that there are uncertainties either way. Analysis by the Institute for Fiscal Studies suggests that this increase will enable the Government to make substantial progress on an AHC basis. This extra investment will enable the Government to make progress step by step towards its goal to halve child poverty by 2010 and eradicate it by 2020.

5.21 By 2004-05, financial support for children through tax credits, Child Benefit and other benefits will have increased by £10.4 billion in real terms from its 1997 level, a rise of 72 per cent. Table 5.1 shows the levels of support that the CTC and Child Benefit will provide for families from April 2004, including the new investment announced in this Pre-Budget Report. The precise amount a family receives depends on their income and circumstances, with support reduced as income rises. Chart 5.1 shows average gains for families as a result of the introduction of the WTC and the CTC and previously announced upratings, and identifies the

additional increase in the child element of the CTC as announced in this Pre-Budget Report.

Table 5.1: Levels of support for families from April 2004

Family income (£ a year) Per cent of families	less than £13,480 30	less than £50,000 85	all families 100
1 child	£3,030	£1,405	£855
2 children	£5,235	£1,980	£1,430
3 children	£7,435	£2,550	£2,005

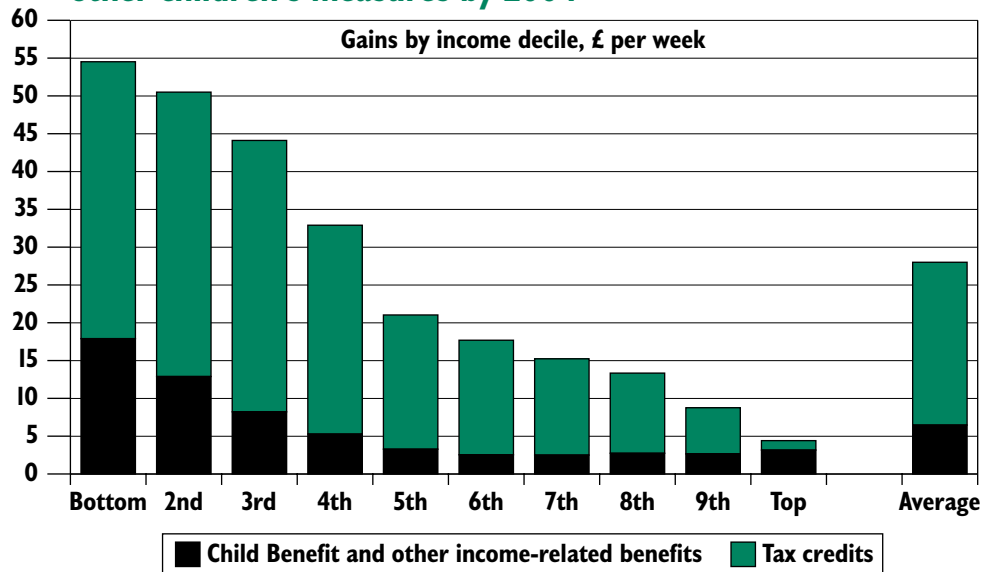


Effects of measures to support families with children

5.22 Chart 5.2 shows the impact by decile, since 1997, of the Government’s reforms for families with children. As a result of the Government’s personal tax and benefit reforms since 1997, including measures due to take effect in 2004-05, by September 2004, in real terms:

- families with children will be, on average, £1,300 per year better off, while those in the poorest fifth of the population will be, on average, £2,900 per year better off;
- a single-earner family on half average earnings with two young children is £3,750 a year better off; and
- a single-earner family on average earnings with two young children is £310 a year better off.

Chart 5.2: Gains for families as a result of tax credits and other children's measures by 2004



5.23 The Government remains determined to continue to make progress beyond 2004-05 and recognises that further investment and reform are needed to ensure the long-term goal of halving and eradicating child poverty is met. The Child Poverty Review, described below, is addressing this. Details of the public service reforms and support for parents that are contributing to reducing child poverty are provided later in this chapter.

Long-term strategy: 2010 and 2020

Long-term measure for child poverty

5.24 The Government is committed to achieving its long-term goal of halving child poverty by 2010 and eradicating it by 2020. It is important that any measure of child poverty helps target policies most effectively and enables the public to hold the Government to account. The Department for Work and Pensions (DWP) consulted last year on options for a measure beyond 2004-05, published preliminary conclusions in May 2003⁵ and will report on this before the end of the year. Relative income will continue to play a key part in any long-term measure of child poverty.

The Child Poverty Review

5.25 In Budget 2003, the Chancellor announced a Child Poverty Review, which will set out the further welfare reform and public service changes required to meet the Government's long-term goal on child poverty. The Review is working across Government, drawing on expertise from the research community and the voluntary sector, and will inform the 2004 Spending Review. It intends to set out the policies necessary to:

- increase employment opportunities, raising incomes for those who can work, including looking at issues such as ethnicity and access to labour markets through public transport;
- support those who cannot work;

⁵ *Measuring child poverty: A consultation document*, Department for Work and Pensions, April 2002.

Preliminary conclusions: Measuring child poverty consultation, Department for Work and Pensions, May 2003.

- improve the effectiveness of public services in tackling deprivation, for example housing and services to tackle debt and financial exclusion;
- increase the contribution of public services to improving the future life chances of children in households suffering low income, for example education, parenting and early years support, and ensure public services and the welfare system work well together when families face crisis points; and
- improve services for children and their families living in deprived areas, including targeted programmes.

The Children's Green Paper **5.26** Public services play an important role in contributing to positive outcomes for families and children, ensuring stability and enjoyment in childhood, extending choice for parents and children, and laying the foundations which allow today's children to guard against the risk of poverty and disadvantage. The Children's Green Paper,⁶ published in September 2003, sets out a vision for transformed services for children, through policies including:

- support for parents and carers, such as the £25 million Parenting Fund;
- early intervention and effective protection, including ensuring that each child in contact with several services has a lead professional, and working to remove legislative and IT barriers to information sharing between professionals;
- accountability and integration to put children at the centre, including the appointment of Children's Directors in Local Authorities, moving towards integrated Children's Trusts at the local level, a major reorganisation of Whitehall responsibilities and the creation of a Children's Commissioner; and
- workforce reform, including a strategy which will review rewards, incentives and relativities across children's practice, and a Sector Skills Council for children and young people's services.

Since publication, the Government has conducted an extensive consultation on the Green Paper, including with children and young people, and a Bill will be introduced to legislate for Children's Directors, a Children's Commissioner and a duty to work closely with partners in the voluntary and community sectors.

Parenting support **5.27** The Government recognises that good parenting is vital for children's educational outcomes, health and social and behavioural development, so parents should be able to receive support long before compulsory schooling begins. The Government is therefore establishing links with primary and nursery schools in 500 communities to help parents give their children the very best start in life. This will help parents of young children to create a positive learning environment in the home and to prepare children for starting school.

⁶ *Every child matters*, Department for Education and Skills, September 2003.

Support for young people

5.28 Opportunities for young people to continue in education after the age of 16 can be hindered by financial circumstances. In recognition of this, the 2002 Spending Review announced that Education Maintenance Allowances (EMAs) would be introduced in the UK from September 2004. Evidence shows that payments to young people in education have a positive impact on the numbers participating and thriving in education. EMAs will be paid directly to young people who stay on in further education after they reach statutory leaving age. They will be paid at three levels – £30, £20 or £10 a week – depending on household income. Young people may also receive bonuses of £100 if they remain on their course and make good progress with their learning. From September 2004, around 290,000 young people in England and Scotland will benefit from this extra help to stay on in post-16 education. Around 475,000 young people in England and Scotland will benefit from EMAs when the scheme is fully rolled out.

Review of financial support for 16-19 year olds

5.29 The improved package of financial support provided by EMAs, the Child Tax Credit and Child Benefit will enable more young people to remain in full-time education. The Government is also committed to supporting young people who choose other paths, such as vocational training and work. The Low Pay Commission is currently examining the case for a national minimum wage for 16 and 17 year olds. At the same time, the Treasury is leading a review of financial support for 16-19 year olds, working with children's groups, relevant Government departments and external stakeholders and in consultation with young people and parents. The review is considering ways of improving the system of financial support in the short term and longer-term reform.

Supporting parents: balancing work and family life

Enhancing choice and support for parents

5.30 The Government is committed to supporting parents in balancing their work and family lives. The Government's strategy involves increasing choice for parents and helping them to fulfil their responsibility for raising children, while working in partnership with business and employee representatives to promote the benefits of flexible working and to encourage the take up of best practice.

Pay and leave for parents

5.31 To help parents choose how to balance their work and family responsibilities the Government has implemented new rights for working parents. Mothers now have a right to up to one year of maternity leave, with 26 weeks paid Ordinary Maternity Leave and a further 26 weeks unpaid Additional Maternity Leave. Statutory Maternity Pay (SMP) has been increased to £100 a week, up from £60 in 2000. New fathers have the right to take two weeks paternity leave, paid at the same rate as SMP. Adoptive parents enjoy similar rights. Since April 2003, mothers and fathers of children under six and of disabled children under 18 have had a right to request flexible working. From April 2004, SMP will increase in line with the RPI from £100 per week to £102.80. This Pre-Budget Report announces that **from April 2004, the Government will uprate Statutory Paternity Pay and Statutory Adoption Pay in line with Statutory Maternity Pay.**

5.32 Although significant progress has been made since 1997, the Government is committed to taking further steps to help parents balance their work and family responsibilities. *Balancing work and family life: enhancing choice and support for parents*,⁷ published in January 2003, set out the Government's strategy in this area and suggested possible next steps for reform. The Government has already implemented some of these steps

⁷ *Balancing work and family life: enhancing choice and support for parents*, HM Treasury and Department of Trade and Industry, January 2003.

and announces further progress in this Pre-Budget Report. The Government is considering a number of further options concerning leave for parents, including:

- allowing parents to take parental leave in one block at the end of maternity or paternity leave;
- extending the period of paid paternity leave and/or introducing unpaid paternity leave;
- extending paternity leave in cases of multiple births and disabled babies;
- extending parental leave and pay rights to foster carers; and
- allowing unpaid maternity leave to count as being in work for tax credit purposes.

The Government will keep the impact of the new measures introduced in April 2003 under review, before considering any further changes.

5.33 The Government has also consulted on allowing fathers time off to attend key antenatal appointments to enable them to become more involved with their baby from the earliest stages. This idea was favourably received by employees, and many employers already offer this option to their staff. The Government will work with employers to promote this as best practice.

Employer supported childcare

5.34 The Government believes that the provision of employer supported childcare can play an important role in helping employees to balance their work and family lives, and can improve staff morale and work performance. The Government consulted earlier this year on proposals to encourage more employers to help their staff with the cost of safe, good quality childcare.⁸ Following the responses to this consultation, the Government is announcing new measures, to be implemented in April 2005, which include:

- **extending the current workplace nurseries tax exemption to cover any formal registered childcare or approved home-childcare contracted by the employer, such as a parent's local nursery, out-of-school club or childminder;**
- **removing the requirement for the employer to have management responsibility for the childcare provision;**
- **a new matching tax exemption for childcare vouchers; and**
- **a rule that where schemes operate, they should be generally accessible to all employees.**

5.35 To ensure that Government support is only provided for good quality care, **the tax and NICs exemption for employer-contracted childcare and childcare vouchers will be restricted to approved childcare.** It will be set at £50 per week per employee to ensure that the exemption is affordable and fairly targeted. The Government will monitor the effect of the financial limit and keep it under review. These measures will extend choice for many parents and employers whose needs are not currently met by a workplace nursery. They will offer real incentives to employers to support good quality, affordable childcare for their employees. The proposals build on the existing help available for good quality childcare through tax credits.

⁸ *Employer Supported Childcare: Improving the Tax and National Insurance exemptions*, Inland Revenue and HM Treasury, February 2003.

Childcare support through tax credits **5.36** The childcare element of the WTC provides support to working parents for the costs of childcare, giving them more financial flexibility to choose the childcare arrangements which are most appropriate for them. Following the introduction of new tax credits, nearly 60 per cent more families are now benefiting from help with childcare costs, with 286,000 families receiving support in October 2003 compared to 180,000 under the WFTC and the DPTC.

5.37 The Government is introducing a number of improvements to the support offered through tax credits. Together with the CTC and its baby addition, these measures will improve financial support to working parents at a time when they need it most, helping to ease the transition to a new family life. From April 2004:

- first time parents who were working at least 16 hours a week before going on maternity, paternity or adoption leave will be able to **claim WTC from the date of birth or adoption of their first child**; and
- as announced in Budget 2003, **mothers on paid maternity leave will be able to receive help with the costs of childcare for their new babies.**

5.38 Parents can now claim support for the costs of using approved childcare in their own home. Currently only registered childminders can become approved home childcarers, so those new to the scheme need to register first as a childminder. The Government will bring forward proposals, for consultation in spring 2004, to streamline this process and widen home childcarers.

Investment in childcare places **5.39** In line with its determination to increase parents' ability to choose how they balance their work and family life, and its commitment to a thriving childcare market, the Government has invested heavily to support the creation of new childcare places. Childcare places for over 1.3 million children have been created since 1997, which puts the Government on course to meet its target of places for 1.6 million children by 2004 and over 2 million children by 2006.

Childcare Review **5.40** The Government has made considerable progress across a number of fronts to support childcare, but recognises that more work is needed. Budget 2003 announced a Childcare Review to inform the 2004 Spending Review, which will consider whether:

- the long-term projection for childcare and early years education is sufficient to meet the Government's aims for employment and educational attainment;
- the expansion is proceeding quickly enough; and
- there are areas where more remains to be done.

FAIRNESS FOR DISABLED PEOPLE

5.41 The Government is determined to ensure that disabled people have the opportunity to lead independent and fulfilling lives. As described in Chapter 4, the Government is piloting measures to trial earlier and more intensive employment support to people with health problems or a disability who have the potential to return to work, enabling them to have genuine choice and opportunity to gain employment.

5.42 Fairness for disabled people requires an end to discrimination in the workplace and beyond. The Government published a draft Disability Bill on 3 December 2003. The draft Bill would increase the opportunities for disabled people, ensuring that they have a greater say in how services are run and thus help to encourage diversity in society.

5.43 To provide extra help for families with disabled children, the disabled child element of the CTC was increased in April 2003 to provide extra help for families with disabled children. It is now worth more than £40 a week on top of the CTC or the child allowances of Income Support or Jobseeker's Allowance. There were 102,000 working families benefiting from the disabled child element of the CTC in October 2003, over three times higher than the 32,000 who benefited from disabled child credits in WFTC/DPTC.

FAIRNESS FOR PENSIONERS

5.44 A fair society guarantees security in old age. This means ensuring security for all pensioners. Building on the foundation provided by the basic state pension, the Government launched the Pension Credit in October 2003 to tackle pensioner poverty and ensure all pensioners can share in rising national prosperity. The Pension Credit, described in Box 5.1, provides extra income for those who need it most and rewards those who have saved modest amounts. Above this foundation, the Government is committed to facilitating effective choices so that individuals, where possible supported by their employers, are empowered to make their own decisions about their retirement and the level of income they will need. The Government is helping today's workers – tomorrow's pensioners – to work and to save more effectively for a secure retirement, through the range of proposals set out in the Government's Pensions Green Paper,⁹ the subsequent document *Action on occupational pensions*,¹⁰ and *Simplifying the taxation of pensions: The Government's proposals*,¹¹ the second consultation document, published alongside this Pre-Budget Report.

Security for all pensioners

5.45 To ensure that today's pensioners have security in retirement, and alongside other measures that help all households on low income, such as the 10 pence starting rate of tax, the Government has:

- increased the basic state pension by more than inflation in each of the last three years. **In April 2004, the full basic state pension will increase further to £79.60 a week for single pensioners and to £127.25 a week for pensioner couples;**
- guaranteed that every April the basic state pension will continue to rise by 2.5 per cent or the increase in the RPI for the previous September, whichever is higher;
- introduced winter fuel payments worth £200 per household each year for the remainder of this Parliament, increased to £300 for over-80 households. Around 11 million people aged 60 or over will benefit from this support this winter;
- introduced free TV licences for households with someone aged 75 or over and free eye tests for all those over 60;
- launched the Pension Credit to guarantee a minimum income and reward those with modest savings; and
- abolished hospital downrating to 52 weeks, introduced concessionary travel for those aged 60 and over and reduced VAT on fuel.

⁹ *Simplicity, security and choice: Working and saving for retirement*, Department for Work and Pensions, HM Treasury and Inland Revenue, December 2002.

¹⁰ *Action on occupational pensions*, Department for Work and Pensions, HM Treasury and Inland Revenue, June 2003.

¹¹ *Simplifying the taxation of pensions: The Government's proposals*, HM Treasury and Inland Revenue, December 2003.

Box 5.1: Pension Credit

To advance its goal of tackling pensioner poverty and to reward saving for retirement, the Government built on the success of the Minimum Income Guarantee (MIG) by introducing the Pension Credit in October 2003. From April 2004, the Pension Credit will guarantee an income of at least £105.45 a week for a single pensioner and £160.95 for pensioner couples. The guarantee element of the Pension Credit will be linked to earnings throughout this Parliament.

Around half of all pensioner households stand to gain an additional £400 a year on average under the Pension Credit, with some gaining up to £1,000 a year. As a result of the MIG and introduction of the Pension Credit, the poorest third of pensioners will be about £600 a year better off on average than if the equivalent amount had been spent on raising the basic state pension.

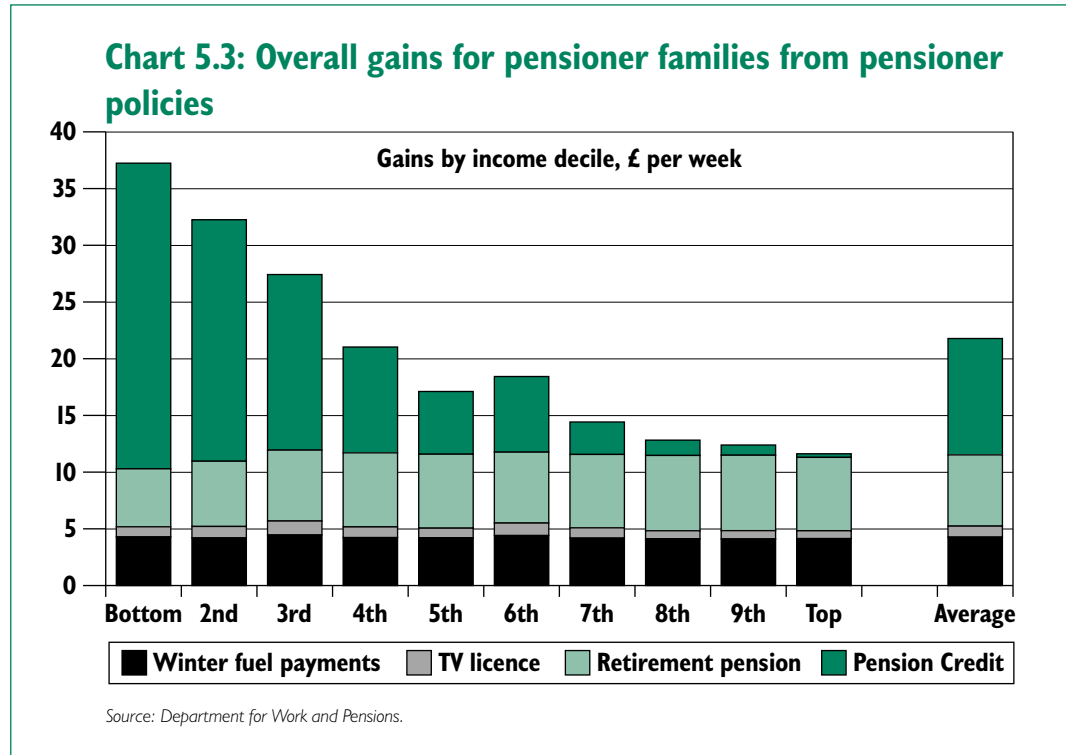
The Government is determined to help and encourage people to claim their entitlements. The Pension Service is promoting a range of measures to encourage claims and increase take up. Advance applications for the Pension Credit have been taken since April 2003, and all eligible applications received before October 2004 will be backdated to the start of the Pension Credit in October 2003 or to the date of the entitlement if that is later. The Government's strategy to maximise take up includes distribution of personal direct mail packs to every pensioner household, explaining the Pension Credit and inviting those likely to be eligible to apply. Widespread advertising, which began in summer 2003, is raising awareness of the Pension Credit. The Pension Service is also working closely with voluntary groups and local authorities to promote take up.

Effects of measures to support pensioners

5.46 From 2004-05, as a result of measures introduced since 1997, including the Pension Credit, the Government will be spending £9.2 billion more in real terms on pensioners. This is £5.7 billion more than the cost of indexing the basic state pension to earnings. Chart 5.3 shows the distributional impact, in current prices, of the Government's measures to support pensioners introduced before April 2004, including the Pension Credit.

5.47 Compared with the 1997 system, as a result of the Government's measures including the Pension Credit, on average, from October 2003:

- pensioner households will be £1,250 a year better off in real terms, or around £24 extra a week; and
- the poorest third of pensioner households will have gained £1,600 a year in real terms.



Support for pensioners who pay tax

5.48 Almost half of pensioners pay no tax, but for those who do, the age-related personal allowances in 2004-05 will rise in line with earnings to £6,830 for people aged between 65 and 74 and to £6,950 for those aged 75 or over. No pensioner aged 65 or over will pay tax on income of less than £131 a week in 2004-05. The age-related personal allowances will continue to rise at least in line with earnings rather than prices for the remainder of this Parliament.

Supporting tomorrow’s pensioners

Taking forward the Pensions Green Paper

5.49 The Government is also acting to support and encourage private pension and other saving above the foundation provided by the state, and to help people work longer if they choose to. The 2002 Pensions Green Paper set out proposals to renew the voluntarist approach to pensions provision, based on a partnership between individuals, employers, the financial services industry and the Government. These proposals included measures to provide much improved information and education; to reinforce pension protection; to simplify the rules around pensions and provide simplified products; as well as a range of measures to help people work longer if they choose and to avoid a cliff edge of retirement.

5.50 The Government consulted widely on the Green Paper, receiving over 800 responses. These contributed to the Green Paper response, *Action on occupational pensions*, which sets out the Government’s first steps in its programme of action. It includes a number of measures to safeguard the rights of members of private sector defined benefit schemes, including:

- the Pensions Protection Fund, the first ever protection scheme for Defined Benefit pensions in the UK, protecting pension rights accrued when a company becomes insolvent;
- ensuring that where a scheme is wound up and its sponsoring employer is solvent, members are more likely to receive the pensions they expected;

- providing a new minimum standard of pension protection for workers in the private sector affected by a Transfer of Undertakings (Protection of Employment) (TUPE) transfer; and
- a new kind of regulator for work-based pensions – taking a proactive, risk-based approach.

5.51 Taking forward improving financial education, John Tiner, Chief Executive of the Financial Services Authority (FSA) is leading work to produce a national strategy to provide consumers with the education, information and generic advice they need to make their financial decisions with confidence.

5.52 The Government is committed to making it easier for employers to provide pensions, and will:

- replace the Minimum Funding Requirement with scheme-specific funding arrangements;
- reduce the cap on the mandatory indexation of pensions from 5 per cent to 2.5 per cent; and
- review the regulation of employers providing advice and information to employees about workplace pensions.

Simplifying the taxation of pensions

5.53 There are currently eight different tax regimes governing pensions, depending on the type of pension and when the individual member joined the scheme. The complexity of these rules imposes unnecessary inflexibility, drives up costs and discourages people from saving in a pension. The proposals in the Government's consultation document, *Simplifying the taxation of pensions: Increasing choice and flexibility for all*, published by HM Treasury and Inland Revenue in December 2002, would radically simplify the taxation of pensions, sweeping away the existing eight different tax regimes for pensions and replacing them with a single lifetime allowance for pension savings that can benefit from tax relief. It also included proposals which would promote:

- flexible retirement, whereby people in occupational schemes will, where their schemes allow it, be able to draw benefits from their pension while continuing to work;
- a single set of rules on pensions in payment that sets the tax-free lump sum at 25 per cent of the value of an individual's pension fund; and
- more flexible annuity rules that stimulate innovation by allowing for the provision of limited period annuities and value-protected annuities.

5.54 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, including:

- reducing the rate of the recovery charge from 33 $\frac{1}{3}$ per cent to 25 per cent, where people exceed the lifetime allowance;
- a single, fair and reasonable factor for valuing defined benefits against the lifetime allowance – 20:1 at all ages;
- the ability to take funds above the lifetime allowance as lump sums, once the recovery charge has been applied;
- more generous transitional arrangements designed to ensure that there is no retrospection – either real or perceived – on contributions and service made or accrued before the simplified regime is introduced; and
- confirmation that unapproved, unfunded arrangements will be allowed, so employers will have a choice whether to offer unlimited pensions within or without the tax-privileged regime.

5.55 The purpose of the Government's proposals for pensions simplification is to cut red tape for business, to provide more flexibility and choice for those saving for a pension, and to give employers and individuals the flexibility to design schemes that suit their needs. They were never intended to raise revenue; with the Government's proposed modifications they would carry a modest cost to the Exchequer.

5.56 The Government has always wanted to proceed by consensus. However, the consultation so far has revealed contrasting views. Many people have expressed support for the proposed simplified regime and the significant benefits that arise including from being able to convert the existing annual cap into a lifetime allowance.

5.57 Others have argued that there is no reason to change the existing regimes, arguing instead that the Government should continue to allow the future build up of uncapped tax-privileged pension rights of those who are exempted from the post-1989 regimes because they joined their existing scheme before that date. They argue that for this group there is no need to apply any cap on the amount of future saving on which tax relief can be received.

5.58 The consultation so far has also revealed contrasting interpretations of the impact of the new proposals. The Government believes, as set out in the first consultation document, that around 5,000 people – either currently in, or previously in, a pre-1989 uncapped pension scheme – will have aggregated pension funds worth £1.4 million or more when these proposals come into force – for these people the Government has ensured that all of their accrued rights are fully protected; and that there may be a further 1,000 people a year, with pension funds currently worth below £1.4 million, who over the next ten years will retire and be affected by the lifetime allowance on account of membership of a pre-1989 regime – for these people the Government has ensured that they can opt out of the simplified regime and protect their accrued rights.

5.59 For all other pension savers, currently subject to the post-1989 regimes, the Government believes that £1.4 million is the lifetime equivalent of the existing annualised earnings cap, equivalent to the maximum pension available under the post-1989 occupational regime, and is therefore – balancing the need to incentivise saving, to ensure fairness, and of public expenditure priorities – the right level for converting the annual limit to a lifetime allowance.

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

- whether it is factually accurate that the £1.4m 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 £1.4m at 5 April 2005; 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 been 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.

Deferring the state pension **5.61** The Government is also acting to deliver its proposals to enable people who wish to work longer and more flexibly to do so, for example by extending choice on reaching state pension age to those who choose to extend their working lives. From April 2005, the Government is increasing the returns from deferring the state pension. People who defer and choose state pension increments will see their pension rise by 10.4 per cent a year instead of the current rate of 7.5 per cent a year. A person deferring a state pension of around £100 a week for five years could see their pension rise to around £152 a week – an increase of around £14.75 a week compared with the current system.

5.62 In addition, for the first time the Government is introducing the option of taking a deferred state pension as a taxable lump sum instead of higher weekly pensions payments. Those choosing to defer their state pension by at least one year from April 2005 will be able to take the lump sum. Interest will be payable on the deferred pension for those choosing the lump sum, which will be taxed at the recipient's marginal rate on their other income to ensure that pensioners do not move into a higher tax bracket as a result of their decision to take a lump sum. Neither will it affect their age-related income tax allowances.

PROMOTING SAVING AND ASSET OWNERSHIP

5.63 The Government's strategy for promoting saving and asset accumulation is founded on its core welfare principles:

- security – helping individuals accumulate a stock of financial assets for times of adversity;
- opportunity – assets enable individuals to take advantage of opportunities throughout life and widen choice; and
- responsibility – developing the saving habit to promote independence.

Building on these principles, the Government aims to widen the opportunities for saving, especially for those on low to moderate incomes.

The Child Trust Fund **5.64** The Government is committed to strengthening the saving habit of future generations and ensuring that all children have a stake in the wealth of the nation. Budget 2003 introduced a new Child Trust Fund (CTF) with entitlement backdated to include children born from September 2002 to align payments with the school year. The CTF will provide an endowment of £250 for every child at birth, rising to £500 for the poorest children – a reform which is both progressive and universal, benefiting every child and with more help for those who it most. The CTF will also be underpinned by increased financial information and education.

5.65 The Government published its detailed proposals for the CTF in October 2003, including an announcement that a further payment would be made at age seven. The Government will continue to work with industry on implementation issues to ensure the successful delivery of CTF accounts, expected in April 2005.

The Saving Gateway **5.66** The Saving Gateway is designed to be an ideal starting point for many low-income individuals who would otherwise have difficulty starting on the savings ladder. The aim of the Saving Gateway is to encourage saving by means of a Government-funded match of all money saved, up to a limit. Tailored financial information and education is provided alongside Saving Gateway accounts to help individuals make informed saving choices. The account would also provide an effective bridge to other forms of saving, such as Individual Savings Accounts (ISAs).

5.67 Pilots of the Saving Gateway are currently being run in Cambridgeshire, Cumbria, Gorton, Hull and Tower Hamlets, four of which are in conjunction with the Community Finance and Learning Initiative, led by the Department for Education and Skills. Nearly 1,500 accounts have been opened. The pilots have been designed to provide a regular stream of information and are being evaluated to assess their impact on savings behaviour, with a final evaluation due in February 2005. The latest interim evaluation results will be available on the HM Treasury website on 11 December 2003. The Government looks forward to further evaluation evidence to assess the effectiveness of matching as a tool to incentivise saving.

Treatment of capital in income-related benefits

5.68 The Government acknowledges that people on low and moderate incomes may be concerned that saving may affect their entitlement to benefits. The Government will keep under review the treatment of capital in income-related working age benefits so that it strikes a sensible balance between providing state support and not unfairly penalising those who have acted responsibly by saving. As a first step, the Government will consider increasing the £3,000 threshold above which savings reduce eligibility to Income Support, Jobseeker's Allowance, Housing Benefit and Council Tax Benefit.

Individual Savings Accounts

5.69 Individual Savings Accounts (ISAs) are the Government's primary vehicle for tax-free saving outside pensions. They have helped to make saving, and the benefits of saving, easier for ordinary investors to understand. Over 15 million people – around one in three adults – now have an ISA and over £120 billion has been subscribed to ISAs since their launch in 1999. Moreover, ISAs have reached groups that were under-represented in Personal Equity Plans (PEPs) and Tax Exempt Special Savings Accounts (TESSAs) – one in five ISA holders are from lower income groups compared with one in seven who had either a TESSA or a PEP. Similarly, the number of people under 25 with ISAs is more than double the number who had either a TESSA or a PEP.

The Sandler review of retail savings

5.70 In July 2002, the Sandler review made a series of recommendations, including the design of a simple product suite that could be marketed outside of the FSA's Conduct of Business regulations. Following a consultation with financial services representatives on this recommendation in February 2003, the Government published a response paper in July 2003,¹² in which it announced specifications for a simple set of low-cost products. The Government's specifications include that:

- the product range will include a pensions product, a medium-term savings vehicle with the option of a smoothed investment, a Child Trust Fund product and a re-branded Charges, Access and Terms (CAT)-mark cash-ISA;
- the medium-term product will have a 60 per cent equity cap and a requirement to diversify to meet the needs of a cautious investor investing for a 5-10 year period; and
- the Stakeholder pension product will require a life-styled default fund, so that investors do not have to make an investment decision unless they choose to do so. The DWP will be consulting on any changes to the Stakeholder Pension regulations in 2004.

¹² *Proposed product specifications for Sandler 'stakeholder' products*, HM Treasury and Department for Work and Pensions, February 2003.

Government response to the consultation on Sandler 'stakeholder' product specifications, HM Treasury and Department for Work and Pensions, July 2003.

5.71 The Treasury has been working closely with the FSA in developing these products. Research by the FSA has shown the simplified sales regime they have been working on needs further development. The Government is keen to continue to take forward work on the sales regime and the product design together, and will therefore delay a decision on the charge caps that will apply to the Stakeholder products until next year. At this time, the Government will publish independent research conducted by B & W Deloitte into the effects on the Stakeholder market of different charge structures and a consultation paper on the regulations for the non-pension products, including the charge caps that will apply.

5.72 The Government announces in this Pre-Budget Report that to help remove unnecessary barriers between different forms of pooled investment, **all Sandler Stakeholder medium-term products and life insurance products will be brought into the stocks and shares component of ISAs from 2005**. Maximum investment limits for the stocks and shares maxi ISA and cash component of the ISA will remain unchanged. This will facilitate the sale of Sandler Stakeholder products, which can have either life insurance or collective investment scheme form. As a consequence, the insurance element of ISAs will cease to exist.

5.73 Following a commitment in the 2002 Pre-Budget Report to amend the taxation of income from offshore funds, **a number of technical changes to the offshore funds regime will now be made**. Other technical changes will be considered to the way in which authorised investment funds are taxed following the FSA consultation on the regulation of authorised investment funds. In addition, the Government will continue to look at Sandler's tax proposals in the wider context of tax issues affecting the market for insurance and pooled investment products such as unit trusts. The Government has noted the views of industry, including the Association of British Insurers and Investment Management Association, on the need for considering longer-term reform and looks forward to hearing their views in more detail.

5.74 The formal period of consultation on the VAT treatment of fund management, announced in the 2002 Pre-Budget Report, has now closed. Responses to the consultation were helpful and expressed a wide range of views. The Government has decided not to make any immediate changes to the VAT treatment of fund management, but to keep the issue under review, especially in the context of the ongoing work on other Sandler tax proposals.

Promoting financial inclusion

5.75 Access to financial services is of central importance in tackling social exclusion and neighbourhood renewal. Many people in deprived areas of the UK are denied the opportunity to save or borrow at reasonable rates, and to accumulate the assets and security that others take for granted. Much has been done over recent years, including the introduction of basic bank accounts and the facilitation of growth and development of the Credit Union movement. However, the Government recognises there is a need for further action in this area and is developing a strategy for tackling financial exclusion going forward.

Access to credit 5.76 While some people on lower incomes would like to save, the Government recognises that for others the immediate priority may be the ability to borrow at reasonable rates. The Government is aware that many find it difficult to gain access to affordable credit. The Consumer Credit White Paper, published by the Department of Trade and Industry on 8 December 2003,¹³ sets out measures to develop a fair and transparent credit market for all consumers, to minimise the number of consumers who become over-indebted and to improve support for those who do. The White Paper sets out the importance of working in partnership with the credit industry and the voluntary sector to address the issues of access to affordable credit and over-indebtedness.

¹³ *Fair, Clear and Competitive: The Consumer Credit Market in the 21st Century*, Department of Trade and Industry, December 2003.

The Social Fund 5.77 The Social Fund provides a safety net of grants and interest free loans for the most vulnerable in times of crisis. Budget 2003 announced an additional £90 million for the budget of the Discretionary Social Fund over the three years to 2005-06. The Government has also implemented some administrative changes to improve monitoring and ensure existing resources are being directed to those most in need.

SUPPORTING COMMUNITIES, CHARITIES AND GIVING

5.78 The Government believes a thriving and active sense of citizenship – strengthened by an independent voluntary and community sector (VCS) and a culture of volunteering and giving – is vital for fair and enterprising communities. Voluntary organisations contribute around £5.8 billion to GDP and the economic value of volunteering is estimated to be over £15 billion. Individual donations, corporate donations and tax relief are together worth about £9 billion. Government support for the sector, which overall, is worth more than £2 billion a year, has been demonstrated by the wide range of tax and spending measures introduced since 1997, worth about £9 billion.

The Corporate Challenge 5.79 The Government launched the Corporate Challenge in July 2003 to increase business involvement in community activity in three main areas: corporate support for employee volunteering; corporate support for and promotion of Payroll Giving Schemes; and corporate charitable activity. More than 50 companies have now nominated Corporate Champions. The Government will work closely with these companies and with other organisations who are already successful in this field, to encourage more companies to contribute to developing healthy and active communities and increasing business involvement in community.

Amateur sport 5.80 Amateur sports clubs are an essential part of community life. Recognising their contribution, the Government introduced the Community Amateur Sports Clubs (CASCs) scheme in Budget 2002 to provide support for amateur clubs through tax breaks for clubs and individuals supporting them. The recent Local Government Act, which introduced mandatory rates relief of 80 per cent for CASCs based in England and Wales, further enhanced the benefits of CASC status. The relief is to take effect from April 2004.

5.81 Since the scheme was introduced, over one thousand sports clubs have now applied to register as CASCs. The Government has today announced its intention to double the corporation tax exemption thresholds for CASCs. **As a result, CASCs will be exempt from corporation tax on profits derived from trading, if their trading income is under £30,000, and on profits derived from property, if their property income is under £20,000. CASCs that do not exceed these thresholds will not have to complete a corporate tax return on an annual basis.** All eligible amateur sports clubs are encouraged to register for CASC status so that they can take full advantage of the reliefs available.

Football Supporters Trusts **5.82** Football Supporters Trusts can play a valuable role in giving football fans a voice in the running of clubs within the community, especially when clubs find themselves facing financial difficulties. The Government is keen to ensure that these trusts fulfil their potential in promoting supporters' interests, and helping clubs to remain viable. The Government will therefore consider how it can best help to support Football Supporters Trusts, in particular by a review of how they are treated by the Inland Revenue.

Museums and galleries **5.83** Every member of society has a right to access the UK's cultural heritage, made possible by public support for museums and galleries. Since the introduction of free entry to the main national museums and galleries, admissions have increased by 70 per cent. Building on this, in Budget 2003 the Chancellor announced a review of the support, exemptions and relief available from the Government for museums and galleries to acquire works of art and cultural property.

Guidestar UK project **5.84** The Guidestar project, financed from the Government's Invest to Save Budget, will compile a database for all charities so that many organisations can access the same information. Guidestar is planning a three-month period of consultation with voluntary and community sector organisations and other stakeholder groups, including Government departments, to scope what is most useful for the widest range of people, so that this can inform the development of the database.

5.85 Government support for the VCS, which overall, is worth more than £2 billion a year, has been demonstrated by the wide range of tax and spending measures introduced since 1997. These measures are set out in Table 5.2. The Review of the VCS is discussed in detail in Chapter 6.

Table 5.2: Measures to support charities and the voluntary and community sector

Tax measures introduced since 1997 for charities		Spending measures introduced since 1997 for the VCS	
1997	Transitional Tax Credit Relief		
1998	Millennium Gift Aid – tax relief to advance education and relieve poverty in poorest countries	1998	Compact on relations between Government and the voluntary and community sector published by the Home Office Comprehensive Spending Review allocated community support grant to Voluntary and Community Unit
1999	Review of charity taxation	1999	<i>Giving Time, Getting Involved</i> report published by the Working Group on the Active Community Report of the Policy Action Team on community self-help
Budget 2000	Getting Britain Giving package	2000	Active Communities cross-cutting review Spending Review allocated £120m as part of the Active Community settlement
April 2000	Simplification and abolition of minimum limit on Gift Aid Extended upper limit on Payroll Giving Introduced 10 per cent supplement on Payroll Giving for three years		
April 2001	Tax relief on gifts of shares VAT relief for museums and galleries	2001	Start up funding for the Experience Corps Listed Places of Worship Grant Scheme
July 2001	Launch of the Giving Campaign		
April 2002	Tax relief for Community Amateur Sports Clubs (CASCs) Tax relief for gifts of real property VAT relief for charity buildings	2002	Re-launch of the Home Office Active Community Unit Cross-cutting review of the role of the voluntary and community sector in service delivery, HM Treasury Spending Review allocated £188m to the Active Community Unit £125m <i>futurebuilders</i> fund £25m Parenting Fund <i>Next steps on Volunteering and Giving in the UK</i> discussion document published by HM Treasury and the Home Office <i>Private Action, Public Benefit</i> published by the Cabinet Office Strategy Unit
November 2002	Extension of 10 per cent Payroll Giving supplement		
April 2003 September 2003	Giving through the Self-Assessment Return Local Government Act. Includes mandatory 80 per cent rates relief for CASCs, to come into force from April 2004.	2003	Launch of the Corporate Challenge <i>Guidance to Funders</i> , published by HM Treasury <i>Voluntary and community sector infrastructure: a consultation document</i> , published by Active Community Unit

DELIVERING A MODERN AND FAIR TAX SYSTEM

5.86 A modern and fair tax system provides incentives to work and save, adapts to changes in business practice and the global economy, and raises sufficient revenue to allow the Government to pursue its objective of providing world class public services.

5.87 In July 2003, the Chancellor announced a major review of the UK's organisations dealing with tax policy and administration, to be led by Gus O'Donnell, Permanent Secretary to the Treasury. The review was tasked with examining the best organisational arrangements for delivering the Government's objectives both now and in the future. The staff of the revenue departments work hard in support of the economic and social well-being of Britain, and the review is studying how their work can best be supported and enhanced. As a result the work is wide-ranging, covering institutional arrangements for delivery and policy issues. It has made good progress and will report very soon.

Protecting tax revenues

5.88 A central requirement of a modern and fair tax system is that everyone pays the proper amount of tax and receives the benefits they are entitled to. Tax avoidance and evasion distort the incentives that the tax system aims to deliver and unfairly shift a greater tax burden onto honest and compliant taxpayers. They also reduce the revenue available to the Government for delivering its objective of providing world-class public services. The Government is therefore determined to take the necessary steps to protect tax revenues for the benefit of all taxpayers, by tackling evasion and fraud, and by addressing areas where tax avoidance risks compromising the integrity of the tax system. The Government will continue to modernise and simplify the tax system to improve the way it delivers its objectives. It will also continue to identify and close down loopholes being exploited in the tax system.

Protecting direct tax revenues

5.89 The Government has introduced measures to increase compliance with the tax system in successive Budgets and Pre-Budget Reports. Budget 2003 announced a new compliance and enforcement package for direct tax and national insurance contributions (NICs), increasing the funds available to the Inland Revenue by £66 million. The Pre-Budget Report announces further steps, including:

- **changes to clarify the law where third parties, such as companies in the same group as an employer, make payments to employees which are not subject to NICs.** The change will ensure that these payments cannot be treated as gratuities which are exempt from NICs;
- **changes to the Foreign Earnings Deduction to ensure that it is only available to genuine seafarers;** and
- **action to close down abuse of film tax relief through exit schemes which seek to avoid tax on the income derived from the film.**

5.90 The Government is determined to tackle non-compliance in the construction industry by contractors who routinely ignore their responsibilities both as contractors and as employers, and by sub-contractors who use artificial schemes to try to pay as little tax as possible. As an element of the reform of the Construction Industry Scheme, set out in Chapter 3, **the Inland Revenue will introduce a new employment status declaration for contractors and will be stepping up its compliance activities in this sector** to ensure that everyone understands and meets their tax obligations.

5.91 The Government has introduced a range of measures and targeted tax reductions to support small businesses; including through reform of capital gains tax, reducing the rate of corporation tax for smaller companies and the introduction of a zero rate, Stakeholder Pensions, and the abolition of advance corporation tax. These measures are encouraging the creation of more small companies, including through self-employed people incorporating their businesses. The Government is keen to ensure the measures it has introduced provide support for these firms taking on the opportunities and responsibilities involved in that transition, and to encourage them to reinvest their profits and grow their businesses. At the same time, the Government is concerned that the longstanding differences in tax treatment between earned income and dividend income should not distort business strategies, or enable reductions by tax planning of individuals' tax liability, and that support should continue to be focused on growth. **The Government will therefore bring forward specific proposals for action in Budget 2004, to ensure that the right amount of tax is paid by owner managers of small incorporated businesses on the profits extracted from their company,** and so protect the benefits of low tax rates for the majority of small businesses.

5.92 The Government is also determined to protect the corporation tax system against legal challenges under EU law. Chapter 3 describes the specific measures the Government is taking to resolve uncertainty in the application of the UK's transfer pricing rules, following discussions with business in the wider context of the Government's proposals for the reform of corporation tax. These discussions on the specific measures, as well as the wider issues raised by legal developments, will continue.

Tackling tax avoidance using trusts

5.93 Trusts have a positive role to play in assisting people to manage their tax affairs, and in particular in holding assets on behalf of vulnerable people. However, the tax regime for trusts has not kept pace with the times and is not always fair. The Government is determined to tackle the exploitation of trusts and to make the system fairer for the less well-off. The Government will therefore act to:

- remove a distortion which provides tax avoidance opportunities for higher-rate taxpayers, by **increasing the tax rate applicable to trusts from 34 per cent to 40 per cent, and the corresponding dividend trust rate from 25 per cent to 32.5 per cent, from 6 April 2004.** Other taxpayers receiving income from trusts will continue to be able to reclaim any excess tax paid by the trustees on their behalf;
- **prevent, with immediate effect, capital gains tax gifts relief being used, either alone or in conjunction with the other reliefs, in schemes involving trusts** which are designed to eliminate, or reduce, the tax charge on capital gains arising on disposals of assets; and
- the Government has also announced that it will consult on a proposed new charge intended to deter abuses of the inheritance tax Gifts with Reservation rules that often involve trusts.

5.94 The Government wants to ensure that trusts set up for particularly vulnerable people are not disadvantaged by the measures set out above and that any existing disadvantages are removed. The Government will discuss how that can be achieved with the trust sector and others. These discussions will also explore ways to make the system of trust taxation less burdensome for those not using them for tax-avoidance purposes, and consider ways to reduce tax compliance costs for smaller trusts.

Tackling indirect tax losses **5.95** *Protecting indirect tax revenues*,¹⁴ published alongside the 2002 Pre-Budget Report, set out the Government's approach to tackling indirect tax losses, including for the first time a strategy to tackle revenue shortfalls across the VAT system. *Measuring and tackling indirect tax losses*,¹⁵ published today, reports progress on each of the strategies. New announcements and key results are set out below.

VAT strategy **5.96** The shortfall in VAT revenue – known as the VAT gap – is caused by a range of taxpayer behaviour, from simple accounting errors through to organised criminal fraud. The VAT strategy is designed to reduce the VAT gap to 12 per cent by 2005-06. It is based on an integrated approach, supporting those businesses trying to be compliant while cracking down hard on those who abuse the system. HM Customs and Excise began to recruit and deploy additional operational resources from April 2003 and over 1,000 staff will be deployed to key areas by 2005-06. In Budget 2003, the Government announced new measures to close VAT avoidance loopholes, as well as the launch of a VAT incentive scheme, to encourage unregistered businesses trading above the registration threshold to come forward and register.

5.97 The latest data show that the VAT gap for 2002-03 was 15.7 per cent. This confirms the problem identified by the Government and underlines the need for its strategic approach to tackling these revenue losses. There are encouraging signs that the VAT strategy and the associated new measures are starting to have an impact. The latest projections for VAT receipts for 2003-04 are running around £2 billion ahead of Budget forecast. To provide further support for the VAT strategy **additional resources are being provided to fund deployment of 450 further staff over the next two years on assurance activity** targeted at areas that represent a significant threat to the VAT yield, and on enhanced efforts to recover debt. In line with the cautious approach to public finances, the Government has included an additional £185 million in 2004-05, rising to £315 million in 2006-07, in the public finances forecast from the extension of the strategy.

VAT missing trader fraud **5.98** Missing Trader Intra-Community (MTIC) VAT fraud represents a concerted attack on the VAT system by organised criminals, resulting in losses that could have been as high as £2.75 billion in 2001-02. As a result of its strategic approach to tackling the problem, the Government now believes that the rapid growth of MTIC fraud seen up to 2000 has been stemmed. In 2002-03 fraud losses fell by about 5 per cent and the new legislative measures to tackle the fraud announced at Budget 2003 have since helped further to stem the revenue leakage. There are indications of a further sharp fall in the early part of 2003-04. Annex A describes the impact of MTIC on UK trade statistics.

VAT avoidance **5.99** The Government announces further steps in this Pre-Budget Report to tackle VAT avoidance schemes and close loopholes in the law, including:

- **immediate legislation preventing the avoidance of VAT when debts are assigned to connected businesses;**
- **new rules to stop businesses benefiting indefinitely by using unfair VAT partial exemption special methods;** and
- following consultation, **legislation tackling abusive VAT grouping.**

¹⁴ *Protecting indirect tax revenues*, HM Customs and Excise, November 2002.

¹⁵ *Measuring and tackling indirect tax losses*, HM Customs and Excise, December 2003.

Tackling tobacco smuggling **5.100** Tobacco smuggling undermines the Government's health objectives, involves serious and widespread criminality, and costs billions of pounds a year in lost tax revenue. In *Tackling Tobacco Smuggling*, published in March 2000, the Government launched a strategy to slow, stabilise and reverse the growth in tobacco smuggling within three years. The success of the first two years of the strategy has continued into 2002-03 with HM Customs and Excise reducing the illicit market share to 18 per cent against a target of 21 per cent.

Oils **5.101** In Budget 2002, the Government launched a comprehensive strategy to tackle the problem of oils fraud, particularly the misuse of duty-privileged fuels such as red diesel and kerosene. The Government set HM Customs and Excise the target of reducing the illicit diesel market in England, Scotland and Wales to not more than 2 per cent by March 2006. In the first year of the strategy the illicit market share fell from 7 per cent in 2001 to 5 per cent in 2002. HM Customs and Excise are also continuing to tackle oils fraud in Northern Ireland, and their activities have contributed to a second consecutive year of increased deliveries of legitimate road fuels into the region, after five years of decline.

Combating alcohol fraud **5.102** The Government is determined to extend further its successful approach to tackling indirect tax losses to alcohol fraud. HM Customs and Excise have already made considerable progress in tackling cross-Channel passenger smuggling of alcohol, which fell by 90 per cent between 2000 and 2002. However, evasion of duty on spirits remains a particular problem. This involves well-organised criminal gangs who abuse trade facilitation provisions in UK and EU law that enable alcohol products to be moved and to change ownership many times before duty is paid. Fraudsters obtain spirits products in duty 'suspense' and divert them for consumption on the domestic market without payment of duty. *Measuring and tackling indirect tax losses*, published alongside this Pre-Budget Report, shows that losses from spirits fraud have been increasing markedly, and in 2001-02 were higher than at any time in the previous decade.

5.103 In the last two years, HM Customs and Excise have taken steps to improve their capacity to identify and prevent alcohol fraud, including the implementation of recommendations made by the Roques report into excise diversion fraud.¹⁶ However, the Government believes that more needs to be done. In late 2001, Customs consulted widely on Roques' recommendation that tax stamps should be introduced for spirits to protect both excise revenues and the UK spirits production industry. The consultation established that tax stamps would be an effective tool in the fight against fraud, enabling illicit product to be more readily identified. However, the Government decided, in view of trade concerns, not to proceed with tax stamps at that time, and instead to explore other options for preventing fraud, including establishing in partnership with the trade a Joint Spirits Fraud Task Force aimed at tracing and tracking illegal spirits consignments. Earlier this year, Customs launched a further consultation on a package of regulatory measures aimed at reducing the opportunities to commit alcohol fraud within the duty suspension system.

5.104 It is now clear that action focused on better detection and disruption of fraud or on simply restricting the duty suspension system is not sufficient to achieve a substantial and lasting reduction in the level of spirits losses. Decisive steps are needed to attack the capacity for diversion within the existing duty suspension system and the inability to distinguish duty paid from illicit product in market settings. The Government has therefore decided:

- **to introduce during 2004 new regulatory controls to support the fight against alcohol fraud**, including changes to the regulations governing warehousekeepers, producers and owners of duty-suspended alcohol, requirements for notification of cash transactions and advance payments, and a scheme for recognising transporters with good compliance histories;

¹⁶ *The collection of excise duties in HM Customs and Excise*, Report by John Roques and the Response by Her Majesty's Government to the recommendations in the report, July 2001.

- **to make preparations for the implementation from early 2006 of the Roques report recommendation to introduce tax stamps for spirits.** This would enable UK duty-paid spirits to be clearly identified by consumers, traders and Customs, and reduce both the opportunities for and profitability of diversion fraud. The Government plans to legislate for tax stamps in the 2004 Finance Bill. **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;** and
- **to set a target for Customs to reduce substantially the illicit share of the spirits market.** Precise details of the target will be announced as part of the 2004 Spending Review.

Details of the new regulatory controls, and of the call for alternative proposals, are set out in a Customs business brief published today. Plans for the implementation of tax stamps and draft 2004 Finance Bill legislation will be published in the spring, along with a draft Regulatory Impact Assessment.

5.105 The Government believes that the action it is taking is both targeted and proportionate to the scale of the problem, and consistent with its wider efforts to reduce losses from fraud across the indirect tax regime. However, the Government recognises that the implementation of tax stamps in particular would involve increased costs to the legitimate trade. Therefore, **once tax stamps were implemented, the Government would consider:**

- **how the current deferment arrangement for spirits duty could be extended as far as practical in recognition of the cash flow effects of purchasing tax stamps;** and
- **freezing spirits duty for the remainder of this Parliament.**

Modernising and simplifying the tax system

Stamp Duty 5.106 In October 2003, the Government announced the next steps in the process of modernising Stamp Duty on land transactions, following the announcement of the main proposals in Budget 2003. The new regime, which took effect from 1 December 2003, will result in a modernised tax which promotes fairness between taxpayers, reduces distortions and prevents avoidance. The recent announcements included a significant change to the proposed charge on the rental element when a new lease is granted, reducing tax bills by £1,500 per lease on commercial transactions and £600 per lease on residential transactions compared to the Budget proposals. The Government has also published a consultation on how the new regime applies to partnerships with introduction from Royal Assent of Finance Bill 2004.

Income tax and NICs 5.107 The income tax personal allowances for those aged under 65 will increase in line with inflation in 2004-05. NICs threshold and limits will also increase in line with inflation. There will be no change in NICs rates for employers and employees, or the profit-related NICs paid by the self-employed, in 2004-2005.

Residence and domicile **5.108** At Budget 2003, the Government published a discussion paper on reform of the residence and domicile rules¹⁷ which set out the principles which the Government believes should underpin any modernisation. The paper promoted a wider debate on the extent to which the tax system might need to change to reflect those principles. Many respondents emphasised the attractiveness of the UK as a place to do business and invest, and identified the tax treatment of skilled workers from overseas as one factor in this attraction. Many also recognise that the current rules may not be appropriate in their treatment of people who stay in the UK for long periods, though there was also a concern that people in this position are treated fairly. Responses to the paper have also signalled a potential need for greater clarity and objectivity in the rules, which have not kept up with increases in international travel and commuting, and the globalisation of parts of the labour market, and so have added to compliance costs for businesses and individuals.

5.109 The Government recognises that this is a complex and far-reaching issue and is determined to proceed on the basis of evidence and in keeping with its key principles. The Government is continuing to examine responses to the background paper and welcomes further contributions. Once this process is complete it will move forward with a formal consultation paper on possible approaches to reform.

Gambling duties **5.110** HM Customs and Excise will shortly publish a summary of responses to the consultation, launched in summer 2003, on options for changes to the current licence-based approach to taxing amusement and gaming machines. The Government is considering the range of views expressed, together with the data provided by the industry and its own analysis, before deciding on the scope and timing of any major changes to the structure of taxation of machines. Any further reform of the gambling taxes will take account of the Government's wider proposals for modernising gambling regulation.

Charitable donations **5.111** The Government recognises the important role that charities play in creating a better society. Budget 2002 announced plans to enable taxpayers to donate tax repayments to charities using the tax return from April 2004. To help ensure as many charities as possible benefit, the Government will reopen the list of charities registered to receive these repayments, and will update this on a quarterly basis.

Gift Aid **5.112** Improvements to the Gift Aid scheme introduced in Budget 2000 have had considerable benefits for the charitable sector. However, they have also had the unintended effect of widening the impact of the special statutory exemption available to some heritage and conservation charities. An increasing number of these charities have introduced schemes which grant free day admission in return for a donation which attracts Gift Aid. The charities can then reclaim the basic rate of tax on the donation. It was not the intention of the exemption to treat admission charges as donations which attract Gift Aid. This has given a considerable benefit to a small group of charities. The Government is determined to maintain the integrity of the Gift Aid scheme and will close this loophole in the legislation. The Government will consult closely on the detail of how this may best be achieved with the charities concerned.

VAT exemption for cultural organisations **5.113** Many cultural attractions such as theatres, galleries, zoos and museums will no longer be required to charge VAT on visitor admissions, giving many attractions scope to reduce their admission charges. To allow affected organisations time to consider and prepare for this change, they will not be required to exempt their admission charges until 1 June 2004. In addition, transitional arrangements are being put in place to protect the position of affected cultural attractions in respect of major building projects in progress on which they had expected to be able to reclaim VAT.

¹⁷ *Reviewing the residence and domicile rules as they affect the taxation of individuals*, Inland Revenue and HM Treasury, April 2003.

EU review of VAT reduced rates **5.II4** The Government has been negotiating with its European partners on a review of the EU rules governing VAT reduced rates. At this time the future of the negotiations is uncertain. It remains the Government's objective to achieve reduced rates of VAT for the purchase of energy-saving materials for DIY installation and for repairs and maintenance to listed places of worship. In the meantime, **the Pre-Budget Report confirms that funding for the listed places of worship grant scheme is in place for a further two years, until the end of March 2006.**

TACKLING GLOBAL POVERTY

5.II5 The Government is committed to achieving the Millennium Development Goals (MDGs) – internationally shared targets to halve extreme poverty, reduce child mortality, achieve universal primary education and reverse the spread of HIV, malaria and other diseases of poverty by 2015. Progress towards the goals is slow and uneven, and many developing countries particularly in Africa will fail to achieve the MDGs unless there is an urgent change of action globally. On current trends, only two out of the 18 global targets are likely to be met by 2015. The Human Development Report 2003¹⁸ stated that while there has been good progress in some areas – such as increasing life expectancy and reducing poverty and illiteracy – many developing countries are worse off now than they were a decade ago. The situation in sub-Saharan Africa is especially critical. At the current rate of progress, sub-Saharan Africa will not meet the poverty MDG until 2147 or the child mortality MDG until 2165.

5.II6 The Government believes that meeting the targets requires a new compact for development between the richest and the poorest countries, with shared obligations. This global plan is based on four pillars:

- a substantial increase in global aid flows, which the Government has proposed in the near term should be done through an International Finance Facility (IFF), coupled with further improvements in aid effectiveness;
- the sequenced adoption of an improved regime for trade that allows developing countries to benefit from and participate on fair terms in the world economy;
- the creation in developing countries of the right domestic conditions for business investment and adoption of high corporate standards by the international business community for engagement as reliable partners in the development process; and
- a new rules-based system for global economic growth and stability under which all countries can prosper, with all countries pursuing agreed codes and standards of fiscal and monetary policy transparency.

The UK's commitment **5.II7** Total UK aid will reach 0.4 per cent of national income by 2005-06, as announced in the 2002 Spending Review. This represents a near doubling of aid resources in real terms since 1997 and fulfils the UK's obligation in line with the EU's commitment to reach an aid ratio of 0.39 per cent by 2006. The Government remains committed to reaching an aid target of 0.7 per cent of national income.

¹⁸ Human Development Report 2003 – *Millennium Development Goals: A Compact among nations to end human poverty*, an independent report commissioned by the United Nations Development Programme.

5.118 The focus of the Department for International Development (DfID)'s support is country-owned poverty reduction strategies. Improved health and education remain key elements as investment in human capital, vital to economic development and poverty alleviation. Since 1997, DfID has committed £1.5 billion to the development of health systems in poorer countries. DfID's bilateral expenditure on HIV/AIDS programmes has risen from £38 million in 1997-98 to over £270 million in 2002-03. The Government has also recently increased its commitment to the Global Fund to fight AIDS, Tuberculosis and Malaria by an extra \$80 million. The Government plans to expand its support for universal primary education to over £1 billion over the next five years and remains committed to making the revised framework of the Education Fast-Track Initiative work to help deliver on the collective pledge at Dakar three years ago to ensure that no sound plans to deliver education for all (EFA) are left unfunded.

5.119 However, progress can only be made through greater international collective action. Additional aid, the first pillar of the global compact, is essential for greater investment in poverty reduction, health and education but also to provide funding for public investment in human, social and physical infrastructure. This investment is the essential counterpart for ensuring that in addition to getting improved access to trade, poorest countries have the capacity to benefit from the opportunities provided by this access; for attracting greater and more stable private investment; and to fund additional debt relief needed to provide a sustainable exit from debt. All of these elements are essential pre-requisites to meet the MDGs by 2015 and are underpinned by the need for additional aid. The best available estimates suggest that an extra \$50 billion a year of development assistance is needed. Donors have pledged an additional \$16 billion by 2006 which leaves a significant funding gap. The Government has therefore proposed an IFF, described in Box 5.4, to raise the resources required.

Box 5.4: International Finance Facility

The Government's aim is to ensure that no country genuinely committed to poverty reduction and good governance should be denied the opportunity of pursuing this goal through lack of resources. Substantial extra resources are needed to achieve this. In order to bridge the gap between what has been pledged and what is still required, the UK has proposed an International Finance Facility (IFF). The IFF is designed to deliver the \$50 billion per year in aid flows necessary to meet the MDGs by frontloading aid through the international capital markets. The Facility would improve aid effectiveness by delivering untied predictable aid flows targeted at the poorest countries, by locking in long-term commitments from donor countries. Funds would then be leveraged from these commitments and disbursed mainly in the form of grants and also additional debt relief. The IFF has the potential to deliver at least an additional \$25 billion a year to Africa.

The Government is working closely with the international community to take this proposal forward. The September 2003 meeting of EU Finance Ministers agreed an EU position ahead of the 2003 Dubai Annual Meetings in support of more work on financing for development, including the IFF. At the Annual Meetings, the World Bank and International Monetary Fund (IMF) were called upon to report back at the Spring and Annual Meetings in 2004 on financing for development issues including aid effectiveness, capacity absorption and financing mechanisms, including the IFF, in order to urgently mobilise the substantial necessary additional resources. Developing and emerging market countries will be closely consulted throughout this process, including a Ministerial conference in spring 2004 focusing on financing for development.

The IFF proposal continues to receive strong support from developing countries, NGOs, faith communities and business.

Trade 5.120 Aid and trade – the second pillar of the global compact – are inextricably linked for poverty reduction, as increased and effective aid is vital to help build infrastructure and ensure a domestic environment in developing countries in which people and firms can produce goods and services efficiently and get them to international markets. The Government continues to be a leading advocate of the multilateral approach and is fully committed to the Doha Development Agenda. A successful conclusion of the WTO trade negotiations is vital for global growth and development. The World Bank estimates that a pro-poor agreement would produce gains for developing countries of nearly \$350 billion in additional income by 2015. Box 5.5 describes the Government's approach to WTO negotiations.

Box 5.5 Trade and the WTO negotiations

Despite the reform to the EU's Common Agricultural Policy (CAP) agreed in June 2003, discussed in Chapter 7, which should reduce trade-distorting EU agricultural support, and the WTO agreement to improve future access to medicines for the poorest people of the world reached in September 2003, the WTO Ministerial session in Cancún failed to secure any significant progress on the Doha Development Agenda.

At Cancún, it was agreed that negotiations would continue in Geneva. The Government is working closely with the EU and other international partners to ensure full political commitment to a multilateral approach to trade liberalisation and to secure substantial and concrete progress. Negotiations should focus on the core issues of importance to developing countries for open and fair markets, especially in agriculture.

The Government is pressing for further flexibility in the EU on the Singapore Issues (investment, competition, transparency in government procurement and trade facilitation) and for significant reform of the EU's CAP regimes which were not included in the June 2003 agreement. In particular, the Government believes that reform of the sugar and cotton regimes, key products for developing countries, is an urgent priority.

Debt relief 5.121 The Government is committed to the rapid and full implementation of the Heavily Indebted Poor Countries (HIPC) Initiative. The 27 countries that have reached Decision Point will benefit from debt relief worth over \$70 billion already committed under the HIPC Initiative, reducing their debt payments by around \$1.3 billion each year. Eight of these countries have also reached Completion Point and had their debts irrevocably cancelled. Up to 16 countries could reach their Completion Points before the end of 2004. The UK already provides 100 per cent debt relief to those countries that have demonstrated a commitment to poverty reduction and has provided \$474 million to multilateral institutions to support the HIPC Initiative.

5.122 The Government is committed to ensuring that the HIPC Initiative delivers a robust exit from unsustainable debt for the world's poorest countries and is concerned that a number of countries may exit the HIPC Initiative facing unsustainable levels of debt. This is due to a variety of factors, including inherent vulnerability to exogenous shocks, such as adverse terms of trade and bad weather conditions, and governance and political factors, including conflict and security issues. The Government has called for donor countries, the IMF and the World Bank to consider how to ensure debt sustainability for these countries and looks forward to receiving their report due in February 2004. Any approach that requires further debt relief needs to be funded from resources, additional to current aid flows, otherwise debt relief merely reallocates resources and moves them from non-indebted poor countries to indebted poor countries. The Government's proposal for an IFF is therefore critical in providing additionality of resources that can be used to fund further debt relief.

Post-conflict support for Iraq 5.123 The UK is working alongside its international partners, including the United Nations and the International Financial Institutions to support the reconstruction of Iraq. At the International Donor's Conference in Madrid in October, the Government pledged a total of £544 million to support the reconstruction of Iraq over the three years from 2003. Of this, £300 million will be for the next two years, including bilateral funds and the UK's share of the proposed EU contribution in Iraq. The commitment announced at Madrid is in addition to the UK's significant contribution towards the costs of maintaining security, which is an essential foundation for reconstruction. The new allocation for reconstruction in Iraq will not affect the UK's continuing commitment to increase aid to poor countries. The Government remains committed to provide £1 billion of bilateral aid for Africa by 2005-06 and to ensure that 90 per cent of bilateral aid goes to the poorest countries who need it most by the same date. 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.

