

# Financial Statement and Budget Report

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## INTRODUCTION

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The Economic and Fiscal Strategy Report (EFSR) explains how the measures and other decisions announced in Budget 2004 build on those already introduced to advance the Government's long-term goals. This chapter of the Financial Statement and Budget Report (FSBR) brings together in summary form all the measures and decisions announced in Budget 2004 that affect the Budget arithmetic, giving their estimated effect on government revenue or spending to 2006-07.<sup>1</sup> It also includes those measures announced since Budget 2003, including in the 2003 Pre-Budget Report.

The chapter also sets out how Budget 2004 measures affect the tax and benefit system and government spending. This includes a summary of the main rates and allowances for the personal tax and benefit system, the business tax system, Value Added Tax (VAT), environmental taxes, and other indirect taxes.

The appendices to this chapter provide additional information on Budget measures:

- Appendix A1 provides details of tax changes and other policy decisions which were announced in Budget 2003 or earlier, but which take effect from or after April 2004;
- Appendix A2 explains in detail how the effects of the Budget measures on government revenues are calculated; and
- Appendix A3 provides estimates of the costs to the Government of some of the main tax allowances and reliefs.

## BUDGET POLICY DECISIONS

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Table A1 summarises Budget 2004 measures and their effects on government revenue and spending. These include tax measures, national insurance contributions (NICs) measures, measures that affect Annually Managed Expenditure (AME), and additions to Departmental Expenditure Limits (DEL). Measures that are financed from existing DEL provisions are not included.

Table A2 summarises the impact on government revenues and spending of other measures introduced since Budget 2003, including those announced in the 2003 Pre-Budget Report.

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<sup>1</sup> The contents of the brackets after each measure in this chapter refer to the line in Tables A.1 and A.2 where its costs or yield is shown. The symbol '-' indicates that the proposal has no Exchequer effect. The symbol '\*' indicates that the effect is negligible, amounting to less than £3 million a year.

**Table AI: Budget 2004 policy decisions**

	(+ve is an Exchequer yield)			£ million
	2004-05 indexed	2005-06 indexed	2006-07 indexed	2004-05 non-indexed
<b>MEETING THE PRODUCTIVITY CHALLENGE</b>				
1 Venture capital schemes: improvements	0	-55	-60	0
2 VAT: revalorise registration and deregistration thresholds	0	0	0	-10
3 Business Premises Renovation Allowance	0	-10	-35	0
4 Capital Allowances: one year increase for small enterprises	*	-55	+15	*
5 Local Authority Business Growth Incentives	0	-150	-300	0
<b>INCREASING EMPLOYMENT OPPORTUNITY FOR ALL</b>				
6 Housing Benefit: align rules with tax credits	-5	-35	-35	-5
7 Housing Benefit and Council Tax Benefit: backdating for up to 12 months	-10	-15	-10	-10
8 Housing Benefit: private sector second round Pathfinders	0	-15	-15	-15
<b>BUILDING A FAIRER SOCIETY</b>				
<b>Supporting families and pensioners</b>				
9 Income tax: index starting and basic rate limits	0	0	0	-610
10 Pensions tax simplification	0	0	-25	0
11 £100 payment to over 70s	-475	0	0	-475
12 Pension Credit backdating for up to 12 months	-5	-15	-15	-5
13 Pension schemes earnings cap: indexation	0	0	0	-5
14 Modernising Trusts	0	0	-5	0
15 Payroll Giving: grant scheme for SMEs	-5	-5	0	-5
<b>Protecting tax revenues</b>				
16 Finance leasing: closing loopholes	+75	+110	+110	+75
17 Life companies	+5	+10	+10	+5
18 Red diesel: supporting the UK oils fraud strategy	+80	+180	+190	+90
19 VAT: transfers of going concern	+155	+140	+125	+155
20 VAT: demonstrator cars	*	+5	+5	*
21 Distributed profits: minimum rate <sup>1</sup>	+10	+340	+490	+10
22 Customs: allocation for alcohol strategy	0	-15	-10	0
<b>Duties and other tax changes</b>				
23 Inheritance tax: index threshold	0	0	0	-55
24 Tobacco duties: revalorise rates	0	0	0	-15
25 Alcohol duties: freeze spirits duty until end of this Parliament	-35	-70	-70	0
26 Alcohol duties: revalorise beer and wine duties and freeze other rates	-5	-5	-5	+155
27 Small breweries' relief: extension	-5	-5	-5	-5

Table AI: Budget 2004 policy decisions

	(+ve is an Exchequer yield)			£ million
	2004-05 indexed	2005-06 indexed	2006-07 indexed	2004-05 non-indexed
<b>PROTECTING THE ENVIRONMENT</b>				
<b>Environment</b>				
28 Enhanced capital allowances for additional energy saving technologies	*	-5	-10	*
29 Landlords' energy saving allowance	*	-10	-10	*
30 Changes to Climate Change Agreement eligibility criteria	-5	-25	-25	-5
31 Climate change levy: freeze	-25	-25	-25	0
32 Aggregates levy: freeze	-10	-10	-10	0
33 Aggregates levy: extension of Northern Ireland credit scheme	-15	-20	-25	-15
34 Recycling of landfill tax revenues	0	0	-245	0
<b>Transport</b>				
35 Fuel duties: revalorise rates from 1 September 2004 and introduce differential between sulphur free and other main road fuels	-300	0	0	+345
36 Fuel duties: increase road fuel gases by 1p over next three years	+5	+10	+10	+5
37 Fuel duties: differentials for bioethanol and biodiesel at 20p until 2007	*	+5	+10	*
38 Company vans: reform	*	-30	-30	*
39 Air passenger duties: freeze rates	-25	-30	-30	0
40 VED: freeze rates	-130	-130	-135	0
<b>TOTAL BUDGET MEASURES</b>	<b>-725</b>	<b>+65</b>	<b>-170</b>	<b>-395</b>

\* negligible

**MEMO ITEMS**Enforcement and compliance<sup>2</sup>Direct taxes compliance package<sup>3</sup>

+155    +465    +925

## Resetting of the AME margin

-1,000    -2,000

<sup>1</sup> Alongside the revenue raised by this measure, tax revenue has been reduced as a result of an increase in the number of self-employed individuals incorporating their business to reduce tax (see Chapter 5). Estimates of the impact of the measure, and of the estimated reduction in tax payments by small businesses incorporated for tax reasons since the last Budget are set out below:

	2003-04	2004-05	2005-06	2006-07
	-250	-420	-50	+80

<sup>2</sup> Forecast impact if operational measures to enhance compliance, or to enhance the powers available to the Revenue Departments.

<sup>3</sup> Net of additional resources allocated to the Inland Revenue.

Table A2 summarises the impact on government revenue and spending of other measures introduced since Budget 2003, including those announced in the 2003 Pre-Budget Report.

**Table A2: Other measures announced since Budget 2003**

	(+ve is an Exchequer yield)			£ million
	2004-05 indexed	2005-06 indexed	2006-07 indexed	2004-05 non-indexed
<b>MEETING THE PRODUCTIVITY CHALLENGE</b>				
a † Improvements to the VAT flat-rate scheme	-10	-25	-30	-10
b † Improvements to R&D tax credit schemes	-15	-25	-25	-15
c † Capital allowances: increases in the thresholds defining SMEs	-100	-170	-125	-100
d † Corporation tax reform: extension of relief for management expenses	-20	-35	-25	-20
e † Corporation tax reform: transfer pricing and thin capitalisation	+25	+40	+25	+25
f Interest and royalties directive	*	*	+5	*
<b>INCREASING EMPLOYMENT OPPORTUNITY FOR ALL</b>				
g † Extend Council Tax Benefit to Bands F, G and H	-10	-10	-10	-10
<b>BUILDING A FAIRER SOCIETY</b>				
h † Child Tax Credit: increase above earnings commitment	-885	-925	-955	-885
i † Employer supported childcare	0	-20	-25	0
j † Working Tax Credit: indexation of elements	0	0	0	-200
k † Working Tax Credit for first time parents	-10	-10	-10	-10
l † Income tax: indexation of allowances	0	0	0	-710
m † National insurance: indexation of rates and limits	0	0	0	+305
n Increase capital limits within means tested benefits	0	0	-15	0
o † Bringing medium term products into ISAs	0	-20	-40	0
p State pension: deferral, lump sum and increments	0	-10	-25	0
q Modernising National Savings and Investments	0	+5	+5	0
r † VAT: cultural bodies	-25	-25	-20	-25
s VAT: exempting sub-contracted fund management services	-25	-25	-25	-25
<b>Protecting tax revenues</b>				
t † Foreign earnings deduction for seafarers (FED)	*	+20	+15	*
u † Reform of the Construction Industry Scheme	+20	+40	+80	+20
v † Modernising the taxation of trusts	+35	+150	+145	+35
w Life policies: anti-avoidance	+30	+50	+40	+30
x † VAT: abusive grouping	+50	+70	+65	+50
y † VAT: partial exemption special methods	+50	+55	+50	+50
z † VAT: assignment of bad debts	+20	+20	+20	+20
aa † Tackling alcohol fraud	+5	+10	+175	+5
bb Insurance premium tax: Changes to GAP insurance	+15	+15	+20	+15
<b>Additional policy decisions</b>				
† Total special reserve allocation	-300	0	0	
<b>TOTAL POLICY DECISIONS</b>	<b>-1,150</b>	<b>-825</b>	<b>-685</b>	<b>-1,455</b>

\* negligible

† Announced in 2003 Pre-Budget Report

Note: As required by the Code for Fiscal Stability, the 2003 Pre-Budget Report economic and fiscal projections were based on, and included the impact of, all Government decisions and all other circumstances where the impact of these decisions could be quantified with reasonable accuracy by the day the projections were finalised.

## PERSONAL TAXES AND SPENDING MEASURES

### Income Tax

- Bands, rates and personal allowances** The starting and basic rate limits are increased in line with statutory indexation and there are no changes to the income tax rates. (9)
- As announced in the 2003 Pre-Budget Report, the personal allowance for those aged 65 and over will increase in line with earnings from 6 April 2004 to £6,830 for those aged 65-74, and for those aged 75 or over to £6,950. Other allowances, including the personal allowance for those under 65, will be increased by statutory indexation. (l)
- The maximum earnings for which pension provision may be made with income tax relief (the “earnings cap”) is increased in line with statutory indexation. (13)
- Individual Savings Accounts** As announced in the 2003 Pre-Budget Report, all Sandler stakeholder medium-term products and life insurance products will be brought into the stocks and shares component of Individual Savings Accounts (ISAs) from 6 April 2005. (o)
- National Savings and Investments** As announced on 24 January 2004, National Savings and Investments introduced a new account called the Easy Access Savings Account (EASA) available from 29 January 2004 to provide more flexible saving. Interest is taxable but paid gross. The EASA replaces the Ordinary Account, and savers have not been able to open new Ordinary Accounts since 28 January 2004. (q)
- Lloyd’s names** A measure will be introduced, with effect from 6 April 2004, to allow Lloyd’s Names to qualify for relief for the carry forward of trading losses and deferral of capital gains on conversion to limited liability underwriting. (\*)
- ITEPA** A package of measures will be introduced to correct anomalies in the Income Tax (Employment and Pensions) Act 2003 (ITEPA). The measures affect both companies and individuals. For companies the majority of measures will be effective from 1 April 2004 but some will apply retrospectively from 1 April 2003. Similarly, for individuals the majority of the measures will be effective from 6 April 2004, but some will apply retrospectively from 6 April 2003. (-)
- MPs’ travel expenses** The tax exemption for the costs of travel of Members of Parliament to EU institutions and other EU parliaments will be extended to cover visits to regional assemblies with effect from 6 April 2004. (\*)
- Company vans** The benefit an employee derives from private use of a company van will be revised from 6 April 2005, there will be a nil charge for vans, where the van has to be taken home but otherwise no private use is allowed. Transitionally, the current rates will remain until 2007 when there will be a single scale charge of £3,000 and an additional charge of £500 for fuel provided for private use. (38)
- Emergency service vehicles** A measure will be introduced, with effect from 6 April 2004, to remove the tax and NICs charge that arises when fire, police and ambulance emergency service workers have to take their emergency vehicles home at night when on call. (\*)
- Pensions tax simplification** A package of measures will be introduced, with effect from April 2006, to simplify radically the current pension tax regime. The existing eight regimes will be replaced with a single universal regime for all tax privileged pension savings. (10)

- Offshore funds** Measures will be introduced to change the rules that determine whether or not an offshore fund qualifies for “distributor” status, which in turn determines the tax treatment of UK residents’ investment in offshore funds. The measures will be effective for accounting periods ending on or after Royal Assent. (\*)
- Company car fuel** The figure on which company car fuel benefit is calculated will be frozen for 2004-05 at the 2003-04 level of £14,400. (-)
- Long-term care** A measure will be introduced to confirm current practice that payments for care under immediate needs annuity policies will not be included in the taxable income of the annuitant. (\*)
- Venture capital schemes** A measure will be introduced to increase temporarily the level of income tax relief for venture capital trusts (VCTs) from 20 per cent to 40 per cent. This will apply from 6 April 2004 and cease on 5 April 2006.
- In addition, several other measures will come into effect from 6 April 2004. Capital gains tax deferral relief for VCTs will be abolished and the annual limit for income tax relief will be increased to £200,000 for both the VCT scheme and the Enterprise Investment Scheme (EIS).
- From 17 March 2004, the EIS and VCT scheme rules on qualifying companies with subsidiaries will be relaxed. This change also applies to the Corporate Venturing Scheme and Enterprise Management Incentives. The rules that relate to investment on the same day for EIS and the provisions that relate to emergency loans will also be relaxed. (l)
- Loaned computer exemption** A measure will be introduced, with effect from 6 April 2004, to extend the benefits tax exemption for computers lent to employees to cover cases where the benefit is treated as general earnings. (\*)
- Child and Working Tax Credits** As announced in the 2003 Pre-Budget Report, with effect from 6 April 2004, the child element of the Child Tax Credit will be increased by £180 per year to £1,625 per year. In addition, the disabled child elements of the Child Tax Credit will be uprated in line with inflation for 2004-05. Elements of the Working Tax Credit will also rise in line with inflation for 2004-05 as will the rates of Child Benefit and Guardian’s Allowance. (h,j)
- Working Tax Credit** From 6 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 Working Tax Credit from the date of birth or placement of adoption of their first child. (k)
- Payment via employer** Payment of Working Tax Credit by employers will be phased out, after a period of consultation with employer groups and business about the transition to direct payment. (-)
- Employer-supported childcare** As announced in the 2003 Pre-Budget Report, from April 2005 employer-contracted childcare and employer-provided childcare vouchers up to £50 a week will be exempt from tax and national insurance. The childcare used must be registered or approved and the benefit must be generally available to all employees where a childcare support scheme operates. (i)
- Childcare support** Tax credit legislation will be amended so that from June 2004 childcare provided by foster carers will be eligible for tax credit support, and will guarantee that parents using breakfast clubs run by schools will be able to claim support for their costs in England, Wales and Northern Ireland. (\*)

**Table A3: Bands of taxable income 2004-05**

2003-04	£ a year	2004-05	£ a year
Starting rate 10 per cent	0 – 1,960	Starting rate 10 per cent	0 – 2,020
Basic rate <sup>1,2</sup> 22 per cent	1,961 – 30,500	Basic rate <sup>1,2</sup> 22 per cent	2,020 – 31,400
Higher rate <sup>2</sup> 40 per cent	over 30,500	Higher rate <sup>2</sup> 40 per cent	over 31,400

<sup>1</sup> The rate of tax applicable to savings income in Section IA ICTA 1988 remains at 20 per cent for income between the starting and basic rate limits.

<sup>2</sup> The rates applicable to dividends are 10 per cent for income up to the basic rate limit and 32.5 per cent above that.

**Table A4: Income tax allowances 2004–05**

	2003-04	£ a year 2004-05	Increase
Personal allowance			
age under 65	4,615	4,745	130
age 65–74	6,610	6,830	220
age 75 and over	6,720	6,950	230
Married couple's allowance <sup>1</sup>			
aged less than 75 and born before 6th April 1935	5,565	5,725	160
age 75 and over	5,635	5,795	160
minimum amount <sup>2</sup>	2,150	2,210	60
Income limit for age-related allowances	18,300	18,900	600
Blind person's allowance	1,510	1,560	50

<sup>1</sup> Tax relief for this allowance is restricted to 10 per cent.

<sup>2</sup> This is also the maximum relief for maintenance payments where at least one of the parties is born before 6 April 1935.

**Table A5: Working and Child Tax Credit rates and thresholds**

	<b>2004-05</b> <b>£ a year</b>
<b>Working Tax Credit</b>	
Basic element	1,570
Couple and lone parent element	1,545
30 hour element	640
Disabled worker element	2,100
Severe disability element	890
50 plus element, 16–29 hours	1,075
50 plus element, 30+ hours	1,610
Childcare element	
– maximum eligible cost for one child	<i>£135 per week</i>
– maximum eligible cost for two or more children	<i>£200 per week</i>
– <i>per cent of eligible costs covered</i>	<i>70</i>
<b>Child Tax Credit</b>	
Family element	545
Family element, baby addition	545
Child element	1,625
Disabled child element	2,215
Severely disabled child element	890
<b>Income thresholds and withdrawal rates</b>	
First income threshold	5,060
<i>First withdrawal rate (per cent)</i>	<i>37</i>
Second income threshold	50,000
<i>Second withdrawal rate (per cent)</i>	<i>6.67</i>
First threshold for those entitled to Child Tax Credit only	13,480
Income disregard	2,500

## **Effects on the Scottish Parliament’s tax varying powers – statement regarding Section 76 of the Scotland Act 1998**

A one penny change in the Scottish variable rate in 2004-05 could be worth approximately plus or minus £270 million, and is broadly unaffected by these changes. In the Treasury’s view, an amendment to the Scottish Parliament’s tax-varying powers is not required as a result of these changes.

### **National insurance contributions**

As announced in the 2003 Pre-Budget Report, the national insurance contributions (NICs) threshold and limits will 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 2004-05.

Other NICs rates for 2004-05 will increase in line with inflation; for the self-employed the rate of Class 2 contributions will be £2.05, the special rate of Class 2 contributions for share fisherman will be £2.70, the rate of Class 3 voluntary contributions will be £7.15 and the special rate of Class 2 contributions for volunteer development workers will be £3.95. (m)

**National Insurance Contributions and Statutory Payments Bill** As announced on 27 October 2003, a package of measures will be introduced with effect from a date to be announced, to help employers decide how to meet their obligations for NICs on securities-based earnings and to align some aspects of debt recovery for Class 2 NICs with income tax.

In addition, further measures will be introduced, with effect from 6 April 2005, to align information powers for NICs with those for tax and to protect employees' rights to Statutory Sick and Maternity Pay by improving means of tackling non-compliance. (-)

**Table A6: Class 1 national insurance contribution rates 2004-05**

Weekly earnings <sup>1</sup>	Employee (primary) NIC rate <sup>2</sup> (per cent)	Employer (secondary) NIC rate <sup>3</sup> (per cent)
Below £79 (LEL)	0	0
£79 to £91 (PS/ST)	0 <sup>4</sup>	0
£91 to £610 (UEL)	11	12.8
Above £610	1	12.8

<sup>1</sup> The limits are defined as LEL – lower earnings limit; PT – primary threshold; ST – secondary threshold; and UEL – upper earnings limit.

<sup>2</sup> The contracted-out rebate for primary contributions in 2004-05 is 1.6 per cent of earnings between the LEL and UEL for contracted-out-salary-related schemes (COSRS) and contracted out money purchase schemes (COMPS).

<sup>3</sup> The contracted-out rebate for secondary contributions is 3.5 per cent of earnings between the LEL and UEL for COSRS and 1.0 per cent for COMPS. For COMPS, an additional age-related rebate is paid direct to the scheme following the end of the tax year. For appropriate personal pensions, the employee and employer pay NICs at the standard, not contracted-out rate. An age and earnings-rebate is paid direct to the personal pension provider following the end of the tax year.

<sup>4</sup> No NICs are actually payable but a notional Class 1 NIC will be deemed to have been paid in respect of earnings between the LEL and PT to protect benefit entitlement. Table A.7 Self-employed national insurance contribution rates 2004-05.

**Table A7: Self-employed national insurance contribution rates 2004-05**

Annual profits <sup>1</sup>	Self employed NICs	
	Class 2	Class 4
below £4,215 (SEE)	0 <sup>2</sup>	
£4,215 and above	£2.05	
£4,215 to £4,745 (LPL)		0
£4,745 to £31,720 (UPL)		8 per cent
above £31,720		1 per cent

<sup>1</sup> The limits are defined as LPL – lower profits limit and UPL – upper profits limit.

<sup>2</sup> The self-employed may apply for exception from paying Class 2 contributions if their earnings are less than, or expected to be less than, the level of the small earnings exceptions (SEE).

## Inheritance Tax

**Inheritance tax** The threshold will be increased from £255,000 to £263,000 for new tax charges arising on or after 6 April 2004. (23)

**Simplifying the administration of inheritance tax** A measure will be introduced to extend the simplified inheritance tax reporting procedures to a further 30,000 estates per year. The necessary changes to secondary legislation will be made later this year. In addition, some of the inheritance tax penalty rules will be updated with effect from Royal Assent to bring them more into line with income and capital gains tax. (\*)

Further personal tax measures are included in the Protecting Tax Revenues section of Chapter A.

## Charities and giving

**Payroll Giving** The Government is launching a Payroll Giving grant scheme. SMEs with fewer than 500 employees who set up new Payroll Giving schemes from April 2004 will be able to apply for a one-off grant payment to assist with the cost of establishing their scheme. The grant will be available for two years. (15)

## BENEFITS

From April 2006, the threshold above which savings reduce eligibility for Income Support, Jobseeker's Allowance, Housing Benefit and Council Tax Benefit will be raised from £3,000 to £6,000. (n)

**Pensions** Pension Credit will be strengthened by extending the backdating provision whereby those claiming beyond October 2004 will see, where eligible, their entitlements backdated by up to 12 months, where applicable. (12)

As announced in the 2003 Pre-Budget Report, those choosing to defer their state pension for at least one year from April 2005 will be able to take a lump sum. (p)

For those who defer their state pension their notional entitlement will be disregarded in calculation of Housing Benefit and Council Tax Benefit. For those who also work, their notional state pension will be disregarded when calculating Working and Child Tax Credits. (\*)

**More help for older pensioners** Alongside Council Tax Benefit, the Government will help pensioner households with someone aged 70 or over with their living expenses with an extra £100 for 2004-05. (11)

**Housing Benefit** A second set of Local Housing Allowance Pathfinders will be introduced in the private rented sector from 2005. (8)

A package of measures will be introduced, taking effect from April 2005, to simplify the rules surrounding entitlement and take-up of Housing Benefit, and how the rules align with those for other support, such as tax credits and Pension Credit. (6)

Housing Benefit and Council Tax Benefit backdating for Pension Credit recipients will also continue to be extended to 12 months in line with Pension Credit. (7)

As announced in November 2003, the restriction limiting Council Tax Benefit to Band E will be lifted for properties in Bands F, G and H from April 2004. (g)

As announced in the 2003 Pre-Budget Report, help for tenants with high childcare costs claiming Housing Benefit will be improved from April 2004. (\*)

**Paternity and Adoption Pay** From April 2004, the Government will uprate Statutory Paternity Pay and Statutory Adoption Pay in line with Statutory Maternity Pay to £102.80 a week. (\*)

## TAXES ON CHARGEABLE GAINS AND STAMP TAXES

### Tax on chargeable gains

- Annual exempt amount** The capital gains tax annual exempt amount is increased in line with statutory indexation to £8,200. (-)
- Taxation of trusts** A package of measures will be introduced, with effect from 6 April 2005, to modernise the taxation of trusts. This will be achieved by establishing common trust definitions and tests across income tax and capital gains tax, and by introducing a basic rate band for small trusts. (14)

### Stamp Taxes

- Stamp Duty Land Tax** A package of measures will be introduced to clarify and amend the current legislation. The majority of the measures will be effective from 17 March 2004 but some will apply from Royal Assent. (\*)
- In addition, a further package of measures will be introduced with effect from Royal Assent that will make permanent the temporary measures that were introduced by Treasury regulation on 5 November 2003 in relation to the new Stamp Duty Land Tax. (\*)
- Further measures concerning taxes on chargeable gains are included in the Protecting Tax Revenues section of Chapter A.

## BUSINESS TAXES AND SPENDING MEASURES

### Tax on business profits

- International Accounting Standards** As announced in the 2003 Pre-Budget Report, measures will be introduced to ensure that companies adopting International Accounting Standards (IAS) to draw up accounts from 1 January 2005 receive broadly equivalent tax treatment to those using UK Generally Accepted Accounting Practice (GAAP). (\*)
- North Sea taxation** As announced in the 2003 Pre-Budget Report, a new Exploration Expenditure Supplement will be introduced to reduce barriers to entry for new North Sea companies not receiving the full benefit of current 100 per cent exploration and appraisal capital allowances. For expenditure on or after 1 January 2004, a company with no tax liability against which to use their allowances can enhance the value of that relief by 6 per cent per year for a maximum of 6 years. (\*)
- Corporation tax reform** As announced in the 2003 Pre-Budget Report, entitlement to corporation tax relief for the expenses of managing investments will be extended. The requirement to qualify as an investment company will be lifted with effect from 1 April 2004. (d)
- As also announced in the 2003 Pre-Budget Report, the transfer pricing rules will be extended to transactions between related entities in the UK from 1 April 2004. The change will be accompanied by measures to mitigate its effect, including exemptions for small and medium-sized businesses, a relaxation of the penalty regime for a transitional period of two years to give businesses time to adjust, and measures to ensure that the new rules will not result in double taxation. (e)
- EU Interest and Royalties Directive** A measure will be introduced, with effect from 1 January 2004, to implement the EU Interest and Royalties Directive (Council Directive 2003/49/EC) in the United Kingdom. This largely eliminates source state taxation of interest and royalty payments between associated companies situated in different EU Member States. (f)

- NHS Foundation Trusts** To ensure consistency with the principles that apply to NHS Trusts, a measure will be introduced with effect from Royal Assent of the Finance Bill to create a power that will be used as necessary to ensure that non-healthcare trading activities of NHS Foundation Trusts that are not carried on within companies are liable to tax. Companies will be taxed in the normal way. (-)
- Tax on non-company distributions** A measure will be introduced to ensure that companies and groups with profits chargeable to corporation tax are charged a minimum rate of corporation tax of 19 per cent on profits distributed to non-company shareholders. The measure will apply to distributions made on or after 1 April 2004. (21)
- Community amateur sports clubs** As announced in the 2003 Pre-Budget Report, a measure will be introduced, with effect from 1 April 2004, to double the corporation tax exemption thresholds for community amateur sports clubs (CASCs). Clubs with trading turnover of less than £30,000 and/or gross property income of less than £20,000 will pay no corporation tax on these sources. (\*)
- Increases to the SME thresholds** As announced in the 2003 Pre-Budget Report, the thresholds for small and medium-sized companies have been increased to the maximum allowed under EU regulations. The measure was effective from 30 January 2004 and applies to financial years ending on or after that date. It doubles the amount of investment eligible for 40 per cent plant and machinery first year capital allowances. Businesses falling under the revised small business threshold are eligible for the 100 per cent first year capital allowance for spending on information and communication technology, until it expires on 31 March 2004 and for the increase to 50 per cent first year allowances announced below. (c)
- Capital allowances for small enterprises** A measure will be introduced to provide an increase in the rate of first year capital allowances for small businesses spending on most plant and machinery from 40 per cent to 50 per cent for one year. The increased allowances will apply to spending incurred on or after 1 April 2004 for businesses in the charge to corporation tax and on or after 6 April 2004 for businesses in the charge to income tax. (4)
- Scientific Research Organisations** The Government will work with Scientific Research Organisations (SROs) to update their tax exemption – bringing it into line with the new research and development (R&D) tax credits definition and reducing their compliance costs through a new monitoring procedure operated by the Inland Revenue. The legislative changes will be brought forward in Finance Bill 2005. (\*)

## Incentives for businesses and employees

- Employee share schemes** A measure will be introduced to provide income tax relief to employees who bear the employers' NIC liability due on post-acquisition earnings from employment-related awards of restricted shares and convertible shares, following the enactment of the National Insurance Contributions and Statutory Payments Bill. (\*)
- Research and Development tax credits** As announced in the 2003 Pre-Budget Report, changes will be made to R&D tax credits. The definition of research and development will be simplified for tax purposes and the range of qualifying costs will be widened. Changes will take effect from 1 April 2004 for large companies and from a date to be announced for SMEs. (b)
- Enterprise Capital Funds** A measure will be introduced to set up Enterprise Capital Funds (ECF). It will apply from a date to be announced. (\*)
- Business Premises Renovation Allowance** As announced in the 2003 Pre-Budget Report, the Government will introduce subject to state aid approval a Business Premises Renovation Allowance Scheme. The scheme will provide 100 per cent capital allowances for the costs of renovating business properties in Enterprise Areas that have been vacant for at least a year. The scheme will be introduced in 2005. (3)

## Other measures

- Local Authority Business Growth Incentives** As announced in the 2003 Pre-Budget Report, a Local Authority Business Growth Incentives Scheme will be introduced from April 2005 to allow local authorities to retain a proportion of growth in local National Non-Domestic Rates revenues. Technical details of the scheme will be announced by the Office of the Deputy Prime Minister in a Press Notice on Budget Day. (5)
- Recognised stock exchanges** The present list of exchanges designated as recognised stock exchanges for certain tax purposes by the Inland Revenue will be reviewed to consider possible amendments, particularly in view of EU enlargement and changes to EC Directives.
- European Company Statute** The Government will conduct a consultation later in 2004 on the tax changes consequent on the European Company Statute.
- Further business tax measures are included in the Protecting Tax Revenues section of Chapter A.

## VALUE ADDED TAX (VAT)

- Simplifying indirect taxes for small businesses** Budget 2004 announces steps that the Government will take to help small and newly-registered business to reduce their compliance costs from 1 April 2004:
- revalorisation of the VAT registration and deregistration thresholds to £58,000 and £56,000 respectively; (2)
  - increasing the turnover ceiling to £660,000 and easing the leaving rules for businesses using the cash accounting scheme; (-) and
  - increasing the turnover ceiling to £660,000 for businesses using the annual accounting scheme. (-)

As announced in the 2003 Pre-Budget Report, from 1 January 2004 the Government revised the flat-rate scheme rates in the light of experience of the scheme, and introduced a new reduced rate to recognise the special circumstances of newly-registered businesses in their first year. (a)

Budget 2004 also announces, from 1 April 2004, an increase to £660,000 in the turnover ceiling beneath which bookmakers are eligible to make three-monthly betting duty returns. (-)

- Modernising and simplifying VAT** As announced in the 2003 Pre-Budget Report, certain cultural organisations, including theatres, galleries, zoos and museums, will be required to exempt admission charges from 1 June 2004. Affected organisations may reclaim VAT in respect of major building projects in progress at 1 June, where this is incurred before 31 May 2007. (r)

From 1 January 2005, the Government will amend the rules that determine the place of a supply of natural gas or electricity to ensure that the supplies are taxed either where the supplier is based or where the supplier consumes the product. (-)

- Fund management services** From 1 August 2003, the VAT exemption for the fund management of authorised unit trusts, trust-based schemes and open-ended investment companies (OEICs) was extended to fund management services provided by third party managers. (s)

Further VAT measures are included in the Protecting Tax Revenues section of Chapter A.

## ENVIRONMENTAL AND TRANSPORT TAXES

- Climate Change Levy** Budget 2004 announces a freeze in the rates of Climate Change Levy (CCL). (31)
- The eligibility criteria for climate change agreements (CCAs), which provide additional entitlement to 80 per cent discounts from CCL, will be extended following the receipt of state aid clearance. (30)

From Royal Assent, Budget 2004 announces legislation to prevent double taxation of energy products used to create biodiesel and bioblend. (\*)

- Landfill tax revenues** As announced in the 2002 Pre-Budget Report, increases in the standard rates of landfill tax will be introduced in a way that is revenue neutral to business and local authorities (34)
- Aggregates Levy** The rate of aggregates levy is frozen at £1.60 a tonne in Budget 2004. (32)
- On receipt of state aid approval, the Northern Ireland relief scheme will be extended for businesses prepared to sign agreements committing them to make environmental improvements to the way they operate. (33)
- Domestic energy efficiency** From 1 June 2004, the reduced VAT rate for domestic installations of energy-saving materials will be extended to include the domestic installation of ground source heat pumps. (\*)
- Landlords energy savings allowance** From 6 April 2004, for a period of 5 years, individual landlords who invest in cavity wall insulation and loft insulation will be allowed to claim an in-year allowance of up to a maximum of £1,500 for the cost of that investment against their taxable profits, on the property in which the installation is made. (29)
- Enhanced capital allowances** The designated energy-saving and water-efficient technologies qualifying for 100 per cent enhanced first-year capital allowances (ECA) will be expanded during 2004, subject to agreement with the European Commission. (28)
- VAT car fuel scale charges** From 1 May 2004, the VAT scale charges are increased to reflect fuel price inflation. These are applied by businesses in order to calculate the amount of VAT due on the consumption of fuel for private motoring. (-)
- Road fuel gases** In line with the commitment in the 2003 Pre-Budget Report to offer three-year rolling certainty for alternative fuels, the duty differential for liquefied petroleum gas (LPG) will be 40.7p/l for 2004-05, 39.7p/l for 2005-06 and 38.7p/l for 2007-08. The differential for natural gas (NG) will be kept at 41p/l until 2007. (36)
- Biodiesel and bioethanol** The 20p per litre duty differential in favour of biodiesel and bioethanol (the latter to be introduced from 1 January 2005) is guaranteed until at least 2007. (37)
- Fuel duties, ultra-low and sulphur-free fuels** From 1 September 2004, duty on ultra-low sulphur petrol and diesel will increase by 1.92p per litre. From 1 September 2004, duty on sulphur-free petrol and diesel will increase in line with inflation. This will increase duty by 1.42p per litre. (35)
- In order to encourage the supply and use of sulphur-free fuels, from Royal Assent, new relaxed rules will apply to the accounting provisions when road fuels attracting different duty rates are mixed in the same commercial tank. (-)
- Red diesel, fuel oil and light oil** From 1 September 2004, duty on rebated gas oil, (red diesel), fuel oil and light oil used as a furnace fuel will increase by 2.42p. (18)
- Fuel substitutes used to generate electricity** Legislation will be introduced later this year to exempt from fuel duty fuel substitutes used in diesel engines to generate electricity. (\*)
- Air passenger duty** The rates of air passenger duty (APD) are frozen in Budget 2004. (39)
- Vehicle excise duty** The rates of vehicle excise duty (VED) are frozen for all vehicles. (40)

**Table A8a: VED bands and rates for cars registered after 1 March 2002 (graduated VED)**

VED band	CO <sub>2</sub> emissions (g/km)	Cars using alternative fuels	VED rate (£)	
			Petrol car	Diesel car
AAA	100 and below	55	65	75
AA	101 to 120	65	75	85
A	121 to 150	95	105	115
B	151 to 165	115	125	135
C	166 to 185	135	145	155
D	186 and above	155	160	165

**Table A8b: VED bands and rates for cars and vans registered before 1 March 2002 (pre-graduated VED)**

Engine size	VED rate (£)
1549cc and below	110
Above 1549cc	165

## OTHER INDIRECT TAXES AND DUTIES

**Tobacco duties** From 6pm on Budget Day 2004, tobacco duty rates will rise in line with inflation to maintain the real price of tobacco. (24)

**Table A9: Changes to tobacco duties**

	Effect of tax <sup>1</sup> on typical item (increase in pence)	Unit
Cigarettes	9.2	packet of 20
Cigars	3.3	packet of 5
Hand-rolling tobacco	9.0	25g
Pipe tobacco	5.5	25g

<sup>1</sup> Tax refers to duty plus VAT.

**Alcohol duties** Excise duty rates on spirits, sparkling wine and cider are frozen, while the rates on beer and wine are increased in line with inflation from midnight on 21 March 2004. (25,26)

From 1 June 2004, the small breweries' duty relief scheme will be extended, on a tapered basis, to breweries producing between 30,000 and 60,000 hectolitres of beer a year. (27)

**Table A10: Changes to alcohol duties**

	Effect of tax <sup>1</sup> on typical item (increase in pence)	Unit
Beer	1	Pint of beer @ 4.2% abv
Wine	1	175ml glass typical strength
Wine	4	75cl bottle typical strength
Sparkling wine	0	75cl bottle typical strength
Spirits	0	70cl bottle 37.5% abv
Spirits-based RTDs	0	275ml bottle @ 5.4% abv
Cider	0	Pint of cider typical strength
Sparkling cider	0	175ml typical strength

<sup>1</sup> Tax refers to duty plus VAT.

**Denatured alcohol** In order to modernise outdated legislation and reduce burdens for business, HM Customs and Excise will consult on new draft legislation – to be implemented in the summer – dealing with “denatured” alcohol. This is alcohol used for a variety of industrial and social purposes, and which is mixed with contaminants in order to make it unfit for drinking. (-)

The duty rates for general betting, pool betting, lottery and bingo are all frozen in Budget 2004. (-)

**Betting and gaming duties** Gaming duty bandings will rise in line with inflation for accounting periods starting on or after 1 April 2004. (\*)

Licence fees for machines in categories B, C, D and E of Amusement Machine Licence Duty (AML) will increase in line with inflation from 22 March 2004. The category A licence fees will be unchanged. (\*)

For accounting periods ending on or after Royal Assent, any pool betting conducted or promoted in the UK, on horse or dog racing will fall within the scope of general betting duty. (-)

**Customs' debts** Following Royal Assent, new rules will provide for the mutual sharing of information between the UK and Andorra, in order to assist with the recovery of customs' debts. (\*)

**Shipbuilders' relief** Following the Government's announcement on 12 January 2004, Budget 2004 confirms the repeal (including repeal having retrospective effect) of the shipbuilders' relief provisions in the 1966 Finance Act. (\*)

**Insurance Premium Tax** Following a policy review, HM Customs and Excise confirmed on 12 February 2004 that supplies of non-financial Guaranteed Asset Protection (GAP) insurance are liable to the higher rate of Insurance Premium Tax when sold through suppliers of motor vehicles or persons connected to them. This revised treatment takes effect from 1 April 2004. (bb)

**Lorry road-user charge** Budget 2004 introduces legislation to assign responsibility for administering Lorry Road-User charge, once the tax is operational, to HM Customs and Excise.

Further indirect taxes and duties are included in the Protecting Tax Revenues section of the chapter.

## PROTECTING TAX REVENUES

**Jointly owned assets** A measure will be introduced, with effect from 6 April 2004, to tax distributions (including dividends) from shares in close companies jointly owned by a husband and wife, according to the actual proportions of ownership and entitlement to the income. (\*)

**Rate applicable to trusts** As announced in the 2003 Pre-Budget Report, the tax rate applicable to trusts will increase from 34 per cent to 40 per cent, and the corresponding dividend trust rate from 25 per cent to 32.5 per cent with effect from 6 April 2004. (v)

**Pre-owned assets** As announced in the 2003 Pre-Budget Report, a measure will be introduced, with effect from 6 April 2005, to charge income tax on people who benefit from free or low-cost enjoyment of assets they formerly owned. (v)

**Restriction of gift relief** As announced in the 2003 Pre-Budget Report, the capital gains tax rules were changed with effect from 10 December 2003 to prevent the exploitation of gift relief on disposals of assets to settlor-interested trusts. (v)

- Private residence relief** As announced in the 2003 Pre-Budget Report, the capital gains tax rules were changed with effect from 10 December 2003 to prevent the interaction between private residence relief and gifts relief being exploited. (v)
- Inheritance tax life-time gifts** A measure was introduced, with effect from 20 June 2003, to apply the gift with reservation rules to gifts made by a married person to a spouse via a trust. (-)
- Life insurance** As announced on 3 March 2004, a measure was introduced to prevent higher-rate taxpayers from using life insurance policies to avoid tax by manufacturing deficiency relief. The measure applies to new policies made on or after 3 March 2004 and to existing policies that are assigned, or become used as security for a debt, or into which policyholders choose to pay additional premiums on or after this date. (w)
- UK equity repos** As announced on 6 November 2003, a measure was introduced with effect from that date to prevent individuals avoiding income tax by entering into repo or stock lending transactions over UK equities. With effect from 17 March 2004, the measure will be extended to trusts and will apply to a capital gains development of the original scheme. (-)
- Partnership avoidance** As announced in the 2003 Pre-Budget Report, a charge to tax will be imposed where investors in film schemes attempt to avoid a charge to income tax on future income. The measures apply to disposals made on or after 10 December 2003.
- As announced on 10 February 2004, partnership losses claimed against other income and gains by 'non-active' partners will be restricted to the amount actually contributed to the business; and disposals of future income streams by 'non-active' partners will be charged to income tax on disposal. The measures apply where losses arise on or after 10 February 2004.
- A measure will be introduced to ensure that a charge to corporation tax will be made where a company shelters taxable profits in a realisation of its share of a partnership interest. This measure will apply to realisations of partnership interests which comprise untaxed profits arising on or after 17 March 2004. (-)
- Gilt strips** As announced on 15 January 2004, a measure was introduced with effect from that date to prevent artificial losses on strips of government bonds being set against other income so as to avoid tax. With effect from 17 March 2004 the measure will also prevent capital losses arising from such arrangements. (-)
- Loan relationships** A package of measures will be introduced to improve the effectiveness of, and close loopholes in, the loan relationship and derivative contracts regimes introduced in Finance Act 2002. These measures will be effective from various dates. (\*)
- Petroleum revenue tax** Two petroleum revenue tax measures will be introduced, with effect from 17 March 2004, to prevent the generation of artificial costs through transactions with connected companies and to prevent the creation of unrelievable field losses through successive transfers of field interests close to decommissioning. (\*)
- Overpayment of tax** As announced on 8 September 2003, a measure was introduced with immediate effect to ensure that, for direct taxes, the same time limits apply to common law actions for relief from the consequences of a mistake of law as apply for other actions to recover direct tax. (-)
- Leasing avoidance** A measure will be introduced, with effect from 17 March 2004, to counter avoidance involving the sale and leaseback or lease and leaseback of plant and machinery that allows businesses to continue to claim capital allowances on the asset but also to claim tax relief on all or most of the lease rentals paid to use the asset. (16)

**Foreign earnings deduction** As announced in the 2003 Pre-Budget Report, a measure will be introduced with effect from 6 April 2004 to re-define 'offshore installation' to ensure that the foreign earnings deduction is only available to genuine seafarers. (t)

**Construction Industry Scheme** The Government will introduce a revised Construction Industry Scheme from April 2006. This will reduce the regulatory burden on the industry, improve compliance, ensure that workers are correctly treated either as self-employed or employees and replace the present cards, certificates and vouchers with an Inland Revenue verification service and monthly returns. (u)

**Payments by third parties** As announced in the 2003 Pre-Budget Report, a measure was introduced with effect from 23 February 2004, to clarify that NICs are due where connected third parties, such as companies in the same group as an employer, make payments to employees. Tips paid to waiters and others in similar employment are not affected by this measure. (-)

**Countering cross-border tax evasion by individuals** As announced on 16 April 2003, UK paying agents will be required to report details of savings income paid to certain overseas residents. This enables the UK in particular to implement the European Savings Directive, which is designed to help combat cross-border tax evasion by individuals on their savings income. Reporting will not start before 1 January 2005. (-)

**Life companies** A package of measures will be introduced for life companies. One measure will counter avoidance using financial reinsurance. This will apply to account periods ending on or after 17 March 2004. In addition, the tax charge on assets retained by life companies following a transfer of business where the assets are retained to meet certain retained liabilities will be removed for transfers of business that take place on or after 17 March 2004.

Anomalies in section 444AD of the Income and Corporation Taxes Act (ICTA) 1988 and section 210A of the Taxation of Chargeable Gains Act 1992 will be corrected. The former applies to transfers of business that take place after 17 March 2004 and the latter applies for periods of account ending on or after 17 March 2004. Also a regulation making power will be introduced in relation to section 804B(7) ICTA 1988, which relates to double taxation relief for life insurance companies carrying on more than one category of business. This will apply from Royal Assent. (17)

**Disclosure requirements** New disclosure rules will be introduced that will require promoters who devise and market certain direct tax schemes to provide details of these schemes to the Inland Revenue, around the time the schemes are sold.

New rules will also require businesses with an annual turnover of £600,000 or more to notify HM Customs and Excise if they use an avoidance scheme listed in secondary legislation. Businesses with a turnover of £10 million or more will also be required to disclose schemes or arrangements bearing certain hallmarks of avoidance.

Details of when the rules will come into effect will be included with the Finance Bill.

**Tackling VAT avoidance** Following the granting of an EC derogation, new rules will counter the contrived arrangements that allow output tax to be avoided when demonstrator cars are made available to employees for their private use. (20)

From 1 August 2004, new eligibility rules will be introduced for corporate bodies wishing to join a VAT group. (x)

# A

## BUDGET POLICY DECISIONS: APPENDICES

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As announced in the 2003 Pre-Budget Report, new rules from 1 January 2004 prevent businesses from gaining the benefit of an unfair partial exemption method indefinitely. (y)

As announced in the 2003 Pre-Budget Report, from 11 December 2003 legislation was introduced to close VAT avoidance loophole where bad debts are assigned to associated businesses. (z)

From 18 March 2004, legislation will close a loophole used by avoiders to escape VAT on the purchase of commercial buildings. (19)

**Tackling alcohol fraud** Budget 2004 introduces legislation, to be implemented early in 2006-07, requiring producers of spirits to apply a UK paid 'tax stamp' to certain of their products.

As announced in the 2003 Pre-Budget Report, the Government will introduce new regulatory controls during 2004 to help further tackle alcohol fraud. (aa)

### ADDITIONAL SPENDING AND DEBT MANAGEMENT DECISIONS

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**Compliance package** A further package to fund additional compliance related activity by the Inland Revenue will be introduced. This package builds on the work begun last year and will further improve the ability of the Inland Revenue to tackle non-compliance and build for the future in key risk areas. The package is expected to yield £2 billion over three years.

**2004 Spending Review** Budget 2004 sets firm overall spending limits for the 2004 Spending Review period. This allows current spending to increase by an average of 2.5 per cent in real terms in 2006-07 and 2007-08, in line with the cautious assumption for trend economic growth and consistent with the cash envelope set out in the 2003 and Pre-Budget Report. Final plans for DEL and AME spending will be set in the Spending Review. Budget 2004 announces that education spending in England will grow by an annual average of 4.4 per cent in real terms across the Spending Review period.

The capital expenditure of the 2004 Spending Review envelope is based on public sector net investment increasing from 2 per cent of GDP to 2¼ per cent of GDP by 2007-08. Net investment remains at 2¼ per cent of GDP in the spending projection of 2008-09.

**Departmental Expenditure Limits** This Budget allocates an additional £80 to the Inland Revenue DEL as part of the new compliance package described in Chapter 5.

An allocation is made to HM Customs and Excise DEL of £12 million a year from 2005-06 for the implementation of an enhanced strategy to tackle alcohol fraud losses, including the implementation of tax stamps for spirits. A further allocation of £3 million is made in 2005-06 for a capital grants scheme to help mitigate the compliance costs to businesses of introducing tax stamps. The precise design and terms of the scheme are subject to further detailed discussions between HM Customs and Excise and the industry. (22)

**Annually Managed Expenditure** In line with usual practice, this Budget sets the Annually Managed Expenditure (AME) margin to £1 billion in 2004-05, and £2 billion in 2005-06.

**Euro preparations** This measure, effective from Royal Assent, provides that the Debt Management Office (DMO) and National Savings and Investments (NS&I) may incur expenditure on preparations for the possible introduction of the single currency. (-)

## APPENDIX AI: MEASURES ANNOUNCED IN BUDGET 2003 OR EARLIER

This appendix sets out a number of tax, benefit and other changes which were announced in Budget 2003 or earlier and which take effect from April 2004 or later. The revenue effects of these measures have been taken into account in previous economic and fiscal projections.

**Table AI.1: Measures announced in Budget 2003 or earlier which take effect from April 2004 or later**

	(+ve is an Exchequer yield)			£ million
	2004-05 indexed	2005-06 indexed	2006-07 indexed	2004-05 non-indexed
a Electronic payment for large employers	+10	+10	+10	+10
b E-filing incentives for payroll	0	-40	-110	0
c Company car tax: emissions level for minimum charge	*	+100	+100	*
d Stamp duty land tax: partnership transactions	+25	+60	+70	+25
e Measures to encourage charitable giving	-30	-20	-10	-30
f Fuel duties: new duty rate for bioethanol from January 2005	-5	-30	-40	-5
g £1 per tonne increase in landfill tax from 2000 to 2004	+140	+145	+150	+115
h Landfill tax: £3 increases from 2005-06	0	+125	+245	0
i Housing benefit disregard	-45	-45	-45	-45
j Transition to work package from October 2004	-10	-15	-15	-15
<b>TOTAL</b>	<b>+85</b>	<b>+290</b>	<b>+355</b>	<b>+55</b>

\* negligible

From April 2004, employers with 250 or more employees will be obliged to use electronic payment for PAYE and other statutory deductions to ensure they are paid promptly. (a)

Regulations made in September 2003 will offer incentives to small employers, and require larger employers, to e-file their PAYE end-of-year returns. This will be phased in over a number of years beginning for the year 2004-05 for business with 250 or more employees. Incentives for small employers to switch to electronic filing will be introduced beginning for 2004-05. (b)

The level of carbon dioxide emissions qualifying for the minimum company car tax petrol percentage (15 per cent) will reduce from 6 April 2005 by 5 grams per kilometre from 145 grams per kilometre to 140 grams per kilometre. (c)

The expected yield from all measures to reform stamp duty on land and buildings in the UK was published in Budget 2002. Details of the measures actually introduced under Stamp Duty Land Tax (SDLT) on 1 December 2003 and revised yields were published in Budget 2003. Following further consultation referred to in the Pre-Budget Report 2003, certain partnership transactions involving interests in land will be brought within the scope of SDLT from Royal Assent. (d)

From 6 April 2004, taxpayers completing a Self-Assessment return will be able to use the return to nominate a charity to receive all or a specified part of any tax repayment that arises. (e)

As announced in Budget 2003, a reduced rate of duty for bioethanol of 20 pence per litre below the rate for sulphur-free petrol will be introduced from 1 January 2005. (f)

In line with the Government's commitment in Budget 1999 to increase the standard rate of landfill tax by £1 per tonne each year until 2004, the rate increases from £14 to £15 per tonne on 1 April 2004. (g)

As announced in the 2002 Pre-Budget Report, the standard rate of landfill tax will increase from £15 to £18 per tonne in 2005-06. (h)

As announced in Budget 2003, from April 2004, the calculation of Housing Benefit will disregard £12.32 of earnings for all tenants who are claiming, or are entitled to claim, the Working Tax Credit, replacing the current 30 hour premium disregard. (i)

As announced in the 2002 Pre-Budget Report, from October 2004, the Job Grant will be available to those who move into work following six months on Jobseeker's Allowance, Incapacity Benefit or Income Support, including lone parents, and a new rate of £250 for households with children will be introduced. Partners of benefit claimants will also be eligible. These arrangements will replace the Back to Work Bonus and the lone parent Income Support run-on. (j)

As announced in the 2002 Pre-Budget Report, from April 2004 claimants of Incapacity Benefit or Severe Disablement Allowance will be treated in the same way as Jobseeker's Allowance and Income Support claimants when they return to work and will benefit from the Housing Benefit run-on. (j)

From 6 April 2004, the restrictions in the childcare element of the Working Tax Credit that prevent mothers on paid maternity leave receiving help with the costs of childcare for their new babies will be removed. (\*)

## APPENDIX A2: EXPLAINING THE COSTINGS

This appendix explains how the Exchequer effects of the Budget measures are calculated. In the context of these calculations, the net Exchequer effects for measures may include amounts for taxes, national insurance contributions, social security benefits and other charges to the Exchequer and, for HM Customs and Excise, penalties.

### Calculating the costings

The net Exchequer effect of a Budget measure is generally calculated as the difference between applying the pre-Budget and post-Budget tax and benefit regimes to the levels of total income and spending at factor cost expected after the Budget. The estimates do not therefore include any effect the tax changes themselves have on overall levels of income and spending. However, they do take account of other effects on behaviour where they are likely to have a significant and quantifiable effect on the yield and any consequential changes in revenue from related taxes and benefits. These include estimated changes in the composition or timing of income, spending or other tax determinants. For example, the estimated yield from increasing the excise duty on petrol would include the change in the yield of VAT and other excise duties resulting from the new pattern of spending. The calculation of the expected effect of changes in duty rates on consumer demand for excise goods assumes that any change in duty is passed on in full to consumers. Where the effect of one tax change is

affected by implementation of others, the measures are generally costed in the order in which they appear in Tables A1, A2 and A1.1.

The non-indexed base columns in Tables A1, A2 and A1.1 show the revenue effect of changes in allowances, thresholds and rates of duty including the effect of any measures previously announced but not yet implemented from their pre-Budget level. The indexed base columns strip out the effects of inflation by increasing the allowances, thresholds and rates of duty in line with prices in this and future Budgets.

A policy which has been previously announced but not yet implemented is also stripped out of the indexed numbers. Measures announced in this Budget are assumed to be indexed in the same way for future Budgets. The indexed base has been calculated on the assumption that, each year:

- income tax and NIC allowances and thresholds and the single person, couple, lone parent and disabled worker elements of the Working Tax Credit increase in line with the Retail Price Index (RPI) to the September prior to the Budget;
- the child element of the Child Tax Credit rises in line with the annual increase in average earnings for the lifetime of the Parliament;
- air passenger duty, climate change levy, aggregates levy, vehicle excise duty and fuel, tobacco and alcohol duties all rise in line with the projected annual increase in the RPI to the September following the Budget; and
- VAT thresholds and gaming duty bands rise in line with the increase in the RPI to the December prior to the Budget.

Implementation dates are assumed to be: Budget day for fuel and tobacco duties; 10 days after Budget day for alcohol duties; May for amusement machine licence duty; July for insurance premium tax; November for air passenger duty; and April for all other taxes, duties and tax credits.

The yields of measures that close tax avoidance loopholes represent the estimated direct Exchequer effect of the measures with the existing level of activity.

These costings are shown on a National Accounts basis. The National Accounts basis aims to recognise tax when the tax liability accrues irrespective of when the tax is received by the Exchequer. However, some taxes are scored on a receipt basis, principally due to the difficulty in assessing the period to which the tax liability relates. Examples of such taxes are corporation tax, self-assessment income tax, inheritance tax and capital gains tax. This approach is consistent with other Government publications.

## Notes on individual Budget measures

### **Pensions tax simplification**

The following notes provide further information on the costings for a small number of issues, to help explain the basis for costing the particular measure or give details of effects on government revenue in the longer term.

The costs include the likely impact of increased pensions savings from those who are constrained by the current rules, as well as the increased flexibility offered by the new regime, such as the ability for some to take a higher tax-free lump sum than under the current regime or for people in occupational schemes to draw benefit from their pension while continuing to work, where their schemes will allow it. It is estimated that the costs are likely to increase to around £250 million by 2009-10.

- Increases to the SME thresholds** The cost declines slowly after 2006-07 as profits are brought back into charge in later years due to the fact that tax relief on investment was accelerated in the first year.
- Venture capital schemes** The costs rise to 2006-07 as VCT investment is increased to take advantage of the enhanced income tax relief, and then in 2007-08 this switches to a net tax saving due to investment brought forward from 2006-07 to benefit from the enhanced relief. From 2008-09 onwards, the additional costs from raised income tax relief thresholds are approximately offset by the tax savings from abolishing capital gains tax deferral for VCT investment.
- Corporation tax reform: transfer pricing and thin capitalisation** After 3 years, the measure is expected to have an ongoing Exchequer cost. This is as the cost of the exemption for smaller businesses begins to outweigh the yield from UK-UK transfer pricing.
- Employer supported childcare** The cost is expected to increase to £60 million by 2009-10.
- Company vans** The cost from 2007-08 is expected to be negligible.
- Capital allowances for small enterprises** The yield in 2006-07 reflects the fact that profits will be brought back into charge from that year onwards due to the fact that tax relief on investment was accelerated in 2005-06. A small but declining yield continues after 2006-07.

## APPENDIX A3: TAX ALLOWANCES AND RELIEFS

This appendix provides estimates of the revenue cost of some of the main tax allowances and reliefs.

Tax reliefs can serve a number of purposes. In some cases they may be used to assist or encourage particular individuals, activities or products, and so may be an alternative to public expenditure. In this case they are often termed 'tax expenditures'. There may, for example, be a choice between giving tax relief as an allowance or deduction against tax, or by an offsetting cash payment.

Many allowances and reliefs can reasonably be regarded (or partly regarded) as an integral part of the tax structure – called 'structural reliefs'. Some do no more than recognise the expense incurred in obtaining income. Others reflect a more general concept of 'taxable capacity'. The personal allowances are a good example: to the extent that income tax is based on ability to pay, it does not seek to collect tax from those with the smallest incomes. However, even with structural reliefs of the latter kind, the Government has some discretion about the level at which they are set.

Many other reliefs combine both structural and discretionary components. Capital allowances, for example, provide relief for depreciation at a commercial rate as well as an element of accelerated relief. It is the latter element which represents additional help provided to business by the Government and is a 'tax expenditure'.

The loss of revenue associated with tax reliefs and allowances cannot be directly observed, and estimates have to be made. This involves calculating the amount of tax that individuals or firms would have had to pay if there were no exemptions or deductions for certain categories of income or expenditure, and comparing it with the actual amount of tax due. The Government regularly publishes estimates of tax expenditures and reliefs for both HM Customs and Excise and Inland Revenue taxes. Largely because of the difficulties of estimation, the published tables are not comprehensive but do cover the major reliefs and allowances.

The estimates in Table A3.1 below show the total cost of each relief. The classification of reliefs as tax expenditures, structural reliefs and those elements combining both is broad-brush and the distinction between the expenditures and structural reliefs is not always straightforward. In many cases the estimated costs are extremely tentative and based on simplifying assumptions. The figures make no allowance for the fact that changes in tax reliefs may cause people to change their behaviour. This means that figures in Table A3.1 are not directly comparable with those of the main Budget measures.

Estimation of behavioural effects is difficult. The sizes of behavioural changes will obviously depend on the measure examined and possible alternative behaviours. For example, removing the tax privileges of a form of saving may just lead people to switch to another tax privileged form of saving.

Table A3.1 also gives details relating to VAT, which is collected by HM Customs and Excise. It shows the estimated yield forgone by not applying the standard rate of VAT (17.5 per cent) to goods and services which are currently zero-rated, reduced-rated, exempt or outside the scope of VAT. Estimates of the scale of structural reliefs for local authorities and equivalent bodies are also shown. Again, the figures are estimates and must be treated with caution. In line with the treatment of Inland Revenue taxes, they make no allowance for changes in behaviour.

The estimated costs of reliefs and allowances given in Table A3.1 cannot be added up to give a meaningful total. The combined yield of withdrawing two related allowances could differ significantly from the sum of individual costs. Similarly the sum of the costs of component parts of reliefs may differ from the total shown.

More details on individual tax allowances and reliefs can be found in the HM Treasury publication, Tax ready reckoner and tax reliefs, published alongside the 2003 Pre-Budget Report.

**Table A3.1: Estimated costs of principal tax expenditures and structural reliefs**

	£ million	
	2002-03	2003-04
<b>TAX EXPENDITURES</b>		
<b>Income tax</b>		
Relief for:		
Approved pension schemes	13,200	13,900
Approved profit sharing schemes	160	–
Share Incentive Plan	100	180
Approved savings-related share option schemes	170	160
Personal Equity Plans	625	575
Individual Savings Accounts	800	950
Enterprise Investment Scheme	190	180
Professional subscriptions	60	60
Rent-a-room	90	90
Exemption of:		
First £30,000 of payments on termination of employment	800	800
Interest of National Savings Certificates including index-linked certificates	140	120
Tax Exempt Special Savings Account interest	100	50
Premium Bond prizes	90	100
Income of charities	900	1,000
Foreign service allowance paid to Crown servants abroad	80	90
First £8,000 of reimbursed relocation packages provided by employers	300	300
Tax credits:		
Life assurance premiums (for contracts made prior to 14 March 1984)	75	65
Children's Tax Credit	2,300	500
Working Families' Tax Credit	750	10
Disabled Person's Tax Credit	40	*
Child Tax Credit	–	2,700
Working Tax Credit	–	700
<b>Income tax and corporation tax</b>		
Film tax relief	300	140
<b>Corporation tax</b>		
R&D Tax Credits	400	430
Relief for clearing contaminated land	75	75
<b>National insurance contributions</b>		
Relief for:		
Approved profit sharing schemes	110	–
Share Incentive Plan	60	110
Approved savings-related share option schemes	120	110
Employer contributions to approved pension schemes	5,100	6,300
<b>Capital gains tax</b>		
Exemption of gains arising on disposal of only or main residence	10,000	10,500

**Table A3.1: Estimated costs of principal tax expenditures and structural reliefs**

	£ million	
	2002-03	2003-04
<b>Inheritance tax</b>		
Relief for:		
Agricultural property	150	160
Business property	130	140
Exemption of transfers to charities on death	350	400
<b>Value added tax</b>		
Zero-rating of:		
Food	9,700	10,050
Construction of new dwellings (includes refunds to DIY builders)	4,300	4,450
Domestic passenger transport	1,850	1,950
International passenger transport (UK portion)	250	250
Books, newspapers and magazines	1,500	1,550
Children's clothing	1,100	1,150
Water and sewerage services	1,000	950
Drugs and supplies on prescription	850	900
Supplies to charities	200	200
Ships and aircraft above a certain size	550	600
Vehicles and other supplies to disabled people	350	400
Lower rate on domestic fuel and power	1,750	1,800
Lower rate for certain residential conversions	100	100
<b>STRUCTURAL RELIEFS</b>		
<b>Income tax</b>		
Personal allowance	35,000	36,200
<b>Income tax and corporation tax</b>		
Double taxation relief	8,000	8,000
<b>Corporation tax</b>		
Life companies reduced rate of corporation tax on policy holders' fraction of profit	450	400
<b>National insurance contributions</b>		
Contracted-out rebate occupational schemes:		
Rebates deducted at source by employers	7,420	7,550
Rebates paid by the Contributions Agency direct to the scheme	300	310
Personal pensions	3,630	3,770
<b>Value added tax</b>		
Refunds to:		
Northern Ireland Government bodies of VAT incurred on non-business purchases under the Section 99 refund scheme	250	300
Local Authority-type bodies of VAT incurred on non-business purchases under the Section 33 refund scheme	5,500	6,100
Central Government, Health Authorities and NHS Trusts of VAT incurred on contracted-out services under the Section 41 (3) refund scheme	3,000	3,500

**Table A3.1: Estimated costs of principal tax expenditures and structural reliefs**

	£ million	
	2002-03	2003-04
<b>RELIEFS WITH TAX EXPENDITURE AND STRUCTURAL COMPONENTS</b>		
<b>Income tax</b>		
Age-related allowances	1,600	2,000
Exemption of:		
British Government securities where owner not ordinarily resident in the United Kingdom	750	750
Child Benefit (including one parent benefit)	980	1,070
Long-term incapacity benefit	630	650
Industrial disablement benefits	90	80
Attendance allowance	250	310
Disability living allowance	500	570
War disablement benefits	110	110
War widow's pensions	70	70
<b>Corporation tax</b>		
Small companies' reduced rate corporation rate	2,150	2,350
Starting rate of corporation tax	300	350
Exemption of gains on substantial shareholdings	260	260
<b>Income tax and corporation tax</b>		
Capital allowances	18,200	18,500
Of which:		
First year allowances for SMEs	170	180
First year allowances for small enterprises for information and communication technology	170	160
Enhanced capital allowances for energy saving technology	150	180
Accelerated capital allowances for Enterprise Zones	170	540
<b>Capital gains tax</b>		
Indexation allowance and rebasing to March 1982	230	230
Taper relief	550	900
Exemption of:		
Annual exempt amount (half of the individual's exemption for trustees)	800	1,050
Gains accrued but unrealised at death	650	650
<b>Petroleum revenue tax</b>		
Uplift of qualifying expenditure	140	210
Oil allowance	440	520
Safeguard: a protection for return on capital cost	200	250
Tariff receipts allowance	50	40
Exemption for gas sold to British Gas under pre-July 1975 contracts	160	150
<b>Inheritance tax</b>		
Nil rate band for chargeable transfers not exceeding the threshold	7,500	8,200
Exemption of transfers on death to surviving spouses	1,500	1,800

**Table A3.1: Estimated costs of principal tax expenditures and structural reliefs**

	£ million	
	2002-03	2003-04
<b>Stamp duties</b>		
Exemption of transfers of land and property where the consideration does not exceed the £60,000 threshold (from December 2003 non-residential land and property threshold is £150,000)	140	110
Exemption of transfers of land and property in designated disadvantaged wards where the consideration does not exceed £150,000 and from April 2003 exemption of all non-residential transfers	70	400
<b>National insurance contributions</b>		
Reduced contributions for self-employed not attributable to reduced benefit eligibility (constant cost basis)	1,200	1,600
<b>Value added tax</b>		
Exemption of:		
Rent on domestic dwellings	2,750	2,900
Rent on commercial property	450	450
Private education	150	150
Health services	650	700
Postal services	400	400
Burial and cremation	100	100
Finance and insurance	2,350	2,500
Betting, gaming and lottery duties	900	950
Small traders	400	400

\* negligible