

Emergency Budget 2010: tough measures for tough times

Not for a political generation or two has a Budget generated such intense interest.

Pre-announcements by the Coalition Government had prepared everyone for large-scale changes to the tax system and for deep public spending cuts.

Many of the details, however, were yet to be revealed as the Chancellor, George Osborne rose to his feet in the House of Commons.

The government is faced with tackling a huge public finance deficit, while at the same time needing to find ways of stimulating growth in the private sector.

What George Osborne presented was a Budget of some £40 billion of austerity measures - £32 billion in spending cuts and £8 billion in tax rises - aimed at not only accelerating the elimination of the UK's structural deficit by 2015/16 but actually balancing the books.

There is to be a fixed target for public debt which will see debt fall as a share of GDP by 2015/16.

Along with a two-year freeze on most public pay, a three-year freeze on child benefit and a 25 per cent reduction in non-ringfenced government department spending over four years, the Chancellor also introduced an eye-catching 2.5 per cent increase in VAT.

To help the less well off, the income tax personal allowance was increased by £1,000 to £7,475 a year and the link between the state pension and earnings put back in place.

Mr Osborne said: "This emergency budget deals decisively with our country's record debt. It pays for the past. And it plans for the future. It supports a strong, enterprise-led recovery. It rewards work. And it protects the vulnerable in our society. Yes it is tough - but it is also fair."

A rise in capital gains was anticipated - it has been one of the pillars of the coalition government's agreement - and it duly arrived. In the event, though, CGT only increased for higher income taxpayers, to 28 per cent.

However, in line with his policy of encouraging the private sector to take up some of the inevitable economic slack that will come with such drastic reductions in public sector spending, the Chancellor offered businesses some tax incentives.

Both large and small company corporation tax is to be cut, and employers will be spared the increase in national insurance contributions planned by the last government.

Predictions for future growth, produced by the recently established and independent Office for Budget Responsibility, were muted, suggesting that there is still much hard work ahead for the economy.

Mr Osborne said that growth will be 1.2 per cent this year, 2.3 per cent in 2011, 2.8 per cent in 2012, 2.9 per cent in 2013 and 2.7 per cent in 2014.

It is the Chancellor's hope that the path his Budget treads over the coming months and years, between trimming the public sector and encouraging the private sector to take up the reins of growth, will lead to a sustained economic recovery. And not a double-dip recession.

What follows is a brief summary of the main points of the emergency Budget.

The economy and government spending

UK economic growth, as predicted by Office for Budget Responsibility, is 1.2 per cent this year, 2.3 per cent in 2011, 2.8 per cent in 2012, 2.9 per cent in 2013 and 2.7 per cent in 2014.

The OBR also forecasted government borrowing of £149 billion this year, £116 billion next year, £89 billion in 2012-13, £60 billion in 2013/14, £37 billion in 2014/15, falling to £20 billion in 2015/16.

As a percentage share of GDP, borrowing will be 10.1 per cent this year but, by 2015-16, it will be 1.1 per cent.

To protect the country's economic infrastructure, there will be no further reductions in capital spending, the Chancellor said.

However, government departmental spending will fall by £17 billion by 2014-15, the equivalent of a 25 per cent drop over four years. More details of where the axe will bite will be announced in the spending review on 20 October.

Public sector pay will be frozen for two years, but safeguards will be introduced for those workers on less than £21,000.

From next year, with the exception of pensions and pension credits, benefits, tax credits and public service pensions will rise in line with the lower consumer prices rather than retail prices, saving up £6 billion across the life of the current Parliament.

Tax credits will be reduced for families earning more than £40,000 and child benefit will be frozen for next three years, although the child element in the tax credit system will rise by £150 above inflation.

VAT

The Chancellor has chosen to raise the basic rate of VAT from 17.5 per cent to 20 per cent.

The change takes effect from 4 January 2011, the move bringing the UK rate in line with that of the EU average.

The 2.5 per cent increase should boost government income by as much as £13 billion a year.

There had been speculation whether the Chancellor would introduce an increase in one step or stagger it across several years.

The one-step introduction will mean a quicker rise in government income, while also saving businesses the administrative costs of managing rises on a yearly basis. Zero rates supplies, such as food, books and children's clothing, exempt supplies and reduced rate items are not affected by the change.

The cash accounting and the annual accounting VAT schemes are also not changed.

However, flat rate scheme rates have been recalculated to take the increase into account.

Capital Gains Tax

As widely anticipated, the rate of capital gains tax has gone up but not for everyone and not by as much as earlier statements suggested, where a match with higher income tax brackets was expected.

Starting from 23 June, there are two CGT rates on gains made on the sale of assets. The CGT for low and middle income earners stays at 18 per cent, but for top rate taxpayers (those earning over £40,000) it rises to 28 per cent.

Tapering and indexation had been considered possible options for the Chancellor as he sought to soften the impact of the rise on smaller investors and savers, but he rejected both in order not to overcomplicate the regime.

The annual exemption holds at £10,100, rising by inflation over the years.

The lifetime limit at which entrepreneurs qualify for a reduced charge of 10 per cent on the sales of assets has been extended to £5 million, up from the previous £2 million.

Corporation Tax and Capital Allowances

Starting from 1 April 2011, the headline rate of corporation tax is to be reduced by 1 per cent each year for four years until it reaches 24 per cent.

The small companies corporation tax rate is also to be reduced next year, down 1 per cent to 20 per cent.

However, the price is going to be a small reduction in the rates for capital allowances.

For most plant and machinery assets, the rate of allowance is to decline from 20 per cent to 18 per cent. For assets with a longer lifespan, the special rate is to drop from 10 per cent to 8 per cent.

The Annual Investment Allowance is also to fall. The AIA enables most businesses to cut their taxable profits by the full amount of their annual capital investment on most plant and machinery up to £100,000 a year. That figure will come down to £25,000.

To give businesses a chance to adapt to the reductions, the Chancellor said that the allowance cuts would not take effect until April 2012.

The research and development tax credit is to remain in place while the government consults on any possible changes to the system.

National Insurance Contributions

It has been a matter of policy for the government to reverse the plans of the previous administration to push up employers' national insurance contributions by 1 per cent as from next April.

Accordingly, the Chancellor said that, from April 2011, the threshold at which employers start to pay national insurance contributions will rise by £21 a week above the rate of inflation.

The Budget also unveiled a new scheme designed to encourage private sector growth in those areas where there is high public sector employment.

Firms that set up outside London and the south-east of England will not have to pay employers' national insurance contributions on the first ten employees they recruit during their first year in business.

The exemption is to be limited to a maximum of £5,000 per employee or £50,000 per firm, and can be applied for at any time over the next three years. The scheme should come into effect as from September 2010, but any new business that sets up from 22 June can benefit provided it meets the relevant criteria.

Income Tax

The Chancellor used the emergency Budget to announce that the personal income tax allowance is to rise next April by £1,000 to £7,475, taking some 880,000 people out of the tax system.

In addition, another 23 million basic income taxpayers are set to receive a tax cut of £170 a year.

However, those on higher incomes will see their allowance thresholds frozen until 2013.

The Chancellor emphasised that the government is committed to raising the personal allowance threshold to £10,000 as a long-term objective, one to be pursued over the duration of the current Parliament.

Pensions

Several aspects of the pensions system are to come under review as a result of announcements made in the Budget.

A consultation on speeding up a planned increase of the state pension age to 66 is to be launched soon.

Another consultation will be held on phasing out the default retirement age of 65.

Former Labour minister, John Hutton is to conduct a review of the cost of public sector pensions, with his interim report due in September and a fuller document to be prepared for next year's Budget.

On the question of reducing pension tax relief for high earners, a policy introduced by the previous government, the Chancellor admitted there were concerns about the complexity of the plans.

But he also insisted that the revenues such a move would generate should be protected. So he promised to examine alternative ways of producing the same amount of revenue (£3.5 billion).

The government will look at restricting pensions tax relief from 6 April 2011, possibly by reducing the annual allowance. Any proposed changes will be the subject of a consultation, but one outcome could see a reduced annual allowance in the region of £30,000 to £45,000.

One definite measure is that, from April next year, the state pension will be linked to earnings, not inflation, and will rise by earnings, inflation or 2.5 per cent, whichever is greater.

Business Support

The Enterprise Finance Guarantee Scheme is to be extended so that it benefits a further 2,000 firms.

The government is also to set up a large Regional Growth Fund which will offer finance for capital projects in the regions over the next two years, with priority being given to those schemes that have the greatest impact on jobs.

More measures for helping SMEs secure finance are to be announced by the Business Secretary, Vince Cable during the summer.

The tax rules on furnished holiday lettings, which were to be changed, remain in place while the government consults on any reforms.

The Environment

The government has confirmed that it will be creating a Green Investment Bank.

The Bank will be used to promote investment in clean energy and green technologies.

The government will also be reassessing the climate charge levy this autumn, and the review will cover the energy tax framework.

There are to be no increases in fuel duty, but a scheme to switch air duty from a per-passenger to a per-plane levy will be looked at in the autumn.