

Emergency Budget June 2010 – Key points, analysis and reaction

Lansons Public Affairs & Regulatory Consulting



Headlines:

- From 4 January 2011 VAT will rise to 20 per cent
- Capital gains tax will rise to 28 per cent for higher rate tax payers
- A banking levy will be introduced from January 2011
- An alternative to removing the higher rate tax relief on pensions to be found
- Earnings link to be restored to the basic state pension
- The income tax personal allowance will be increased by £1,000 to £7,475
- Employer national insurance contributions threshold will rise by £21 a week above inflationary rises from April 2011
- Compulsory annuitisation aged 75 will be scrapped from April 2011
- A Departmental Spending Review will be announced on Wednesday 20 October
- The country will not be joining the Euro during this Parliament

Overview

This was, in the Chancellor's words, the 'unavoidable' Budget. This was the Budget that would impose some of the tightest constraints on public spending seen in recent times, and we could be in no doubt that this was going to be tough. Osborne, Cameron and, symbolically, Clegg have embarked on a coordinated attempt to soften the public mood in recent weeks. Yet for all this pre-emptive rhetoric the Budget goes further than expected in reducing the structural deficit.

A public sector employee earning more than £21,000 will see their pay frozen for two years. The banking sector will face a levy on their balance sheets and higher rate taxpayers will have to pay 28 per cent, not 18 per cent, capital gains tax from midnight tonight. But it is not just the well heeled and bankers who share the pain, with a sharp VAT increase all consumers will see their bills rise with the poorest feeling the pain most acutely.

The political machinations behind the Budget are more interesting than the perennial Blair-Brown struggles. At the tender age of 39, (which makes Osborne the youngest Chancellor since Randolph Churchill and younger than the England goalkeeper David James), Osborne has to set out clearly how he will eliminate the structural deficit whilst assuaging two political factions; the 'Redwood right' of his own party, who will find the increase in CGT hard to stomach and the social democrat Lib Dem for whom the VAT increase is an anathema. If either of these two political cleavages becomes substantially opposed to the Government's programme, the coalition's political legitimacy and functionality will be compromised.

However, Osborne is a famously astute politician who has made a careful political calculation that the Government can withstand the backlash, and there are several considerations which suggest they can. First, the ground has been prepared – the public have been extensively warned that these spending reductions are coming and attitudes have softened to cuts. Second, with a weak opposition and a political honeymoon this is the right time to frontload the pain. Third, for all the Lib Dem squeamishness about the cuts, seeing the rate of CGT increase and the personal income tax threshold rise will be a powerful reminder that only in the coalition Government can they make our society fairer.

Themes

- The 'unavoidable' Budget
- Raise from ruins a balanced economy
- Create an economy that is not overly reliant on any one sector, including financial services
- An economy where prosperity is shared
- Everyone will be asked to contribute – we are all in it together

Key points from Chancellor of the Exchequer's speech

Public Finances and Growth

- Growth for the UK economy predicted to be 1.2 (revised down from 1.3) per cent this year according to the OBR, rising to 2.3 per cent next year
- Borrowing for 2010-11 will be 149bn
- Government expenditure to rise from £637 billion in 2010/2011 to £711 billion in 2015/16, largely due to rising debt interest payments

- But public sector net borrowing will be £149 billion this year, falling to £116 billion next year, then £89 billion in 2012-13, and £60 billion by 2013-14.
- The Government seeks additional £17bn of departmental Budget cuts by 2014-15, implying average real cuts of 25 per cent for unprotected departments. It notes, however, that further reductions in welfare expenditure should seek to reduce this level of departmental cutting
- The amount provided by the Civil List to fund the Queen's duties as Head of State will remain frozen at £7.9m, and will be subject to scrutiny from the National Audit Office and Public Accounts Committee, as per all other items of Government expenditure
- The Government will look to sell a range of assets including the air traffic control system, the student loan book and the tote
- Consumer price index target remains at two per cent. It is expected to be 2.7 per cent at the end of this year and on target the following year
- Departmental spending review to announce findings on 20 October
- Chancellor confirms there will be no further reductions in capital spending totals in this parliament
- Osborne says public sector workers will have a two-year pay freeze. But those earning less than £21,000 will be exempt and will receive a pay rise of at least £250 per year over that period
- 77 per cent of the total consolidation plan to be delivered from lower spending; 23 per cent from higher taxation
- Structural current deficit should be in balance by 2015-16, the final year of this Parliament

Welfare

- Welfare control measures to save £11 billion by 2015
- From next year, benefits payments – with the exemption of pensions – will be up-rated in line with consumer price inflation not retail price inflation
- Tax credit payments for families earning over £40,000 per year to be reduced
- The Health in Pregnancy grant will be abolished. The Sure Start maternity grant will be restricted to the first child only. The Government will also freeze child benefit payments for the next three years
- Medical assessment for Disability Living Allowance will be introduced from 2013 for both new and existing claimants. However, the allowance will not be reduced
- Government to review housing benefit and introduce new limits of £280 per week for two bed properties and £400 per week for four bed properties. The Government expects these changes to save £1.8 billion per year or seven per cent of total housing benefit spending

Business

- Corporation tax to be cut by one per cent a year over the next four years, taking it to 24 per cent by 2014-15. This will make the tax one of the lowest in Europe and the G20
- Extension of the Enterprise Finance Guarantee Scheme
- The small companies tax rate will be cut to 20 per cent, reversing the planned rise to 22 per cent and benefiting 850,000 businesses
- From April 2011, the threshold for National Insurance will rise by £21 per week above inflation to ease the cost of hiring new staff.
- Businesses outside of London and the South East will be exempt from up to £5,000 of employer national insurance payments for each of their first 10 employees hired

- The Annual Investment Allowance will be reduced from £100,000 to £25,000 by April 2012, to allow the Government to concentrate on helping smaller businesses. The Government estimate that 95 per cent of companies will still be covered by this allowance
- There will be measures to cancel certain backdated business rates bills, including for many businesses in ports
- The Government will publish a green paper on business finance before the summer parliamentary recess

Banking

- A banking levy on balance sheets will be introduced from January 2011. It is proposed that the levy will be set at 0.07 per cent with a lower initial rate of 0.04 in 2011.
- Tier one assets will be exempt from the levy, which is expected to raise in excess of £2 billion.
- France and Germany, in a joint statement with the UK, pledge to implement a similar domestic bank levy
- A “Green Investment bank” will be created to invest in environmentally friendly ventures. Details will be announced after the Comprehensive Spending Review in October

VAT and Duties

- VAT will rise from 17.5 per cent to 20 per cent on 4 January 2011
- This will generate £13.5bn per year. Current exemptions on food, children’s clothing, newspapers and printed books will remain
- There will be no increase of duties on alcohol, tobacco or fuel
- The Government will look at measures to stabilise fuel pump prices
- Planned increases in duties on cider will be repealed at the end of the month
- The Government will look at an aviation tax shift from per passenger to per plane

Insurance Premium Tax

- This has risen from five to six per cent at the normal rate
- The higher rate will rise in line with VAT, from 17.5 to 20 per cent

Capital Gains Tax

- Capital gains tax will rise from 18 per cent to 28 per cent for higher rate taxpayers from midnight tonight.
- Basic rate taxpayers will continue to pay capital gains tax at the current rate of 18 per cent
- The annual exemption of £10,100 will remain and will rise in line with inflation
- The 10 per cent capital gains rate for entrepreneurs will be extended from first £2 million of qualifying gains, to the first £5 million of qualifying gains made over a lifetime
- Noted that Treasury analysis showed that a rate higher than 28 per cent would have resulted in smaller revenues

Income tax

- The income tax personal allowance will rise by £1000 from £6,475 - £7,475 in April 2011, taking 880,000 workers out of income tax altogether
- The higher rate of income tax will be frozen until 2013-14
- The Government has committed to extending the income tax personal allowance to £10,000 by the end of the parliament

Pensions and Savings

- From April next year the earnings link on the basic state pension will be re-introduced; triple-lock ensures that it will rise in line with the higher of earnings, prices or 2.5 per cent
- Pensions tax relief – work with industry on alternatives for raising the same amount of revenue from planned removal of higher rate of relief
- John Hutton (former Secretary of State for Work and Pensions and soon to be a Labour Peer) will chair an inquiry into public sector pensions; the full report will be ready by Budget 2011
- The Government will review when the State Pension Age will rise to 66
- A consultation will take place shortly on phasing out the default retirement age from April 2011
- The Government has committed to ending compulsory annuitisation aged 75 from April 2011
- The Saving Gateway scheme will not be introduced in July this year
- The Government has asked the Consumer Finance Education Body (CFEB) to develop a new annual family health check, which will be introduced in spring 2011 as part of the national financial advice service.
- The Government has confirmed it will index link the annual ISA limit from 2011-12
- The Government will not extend life insurance deficiency relief

Other

- The Government will help local authorities – who “can keep their cost increases low” – freeze council tax for a year from April 2011
- The planned landline tax will be abolished, with private sector investment on broadband supported by the under-spend from the digital switchover fund
- There will be no tax relief for the video games industry
- Favourable rates for furnished holiday lettings will be reinstated; cancel backdated business rates payable

Tax avoidance

- Review areas of the tax system in which repeated changes have been necessary to close loopholes and seek to strengthen the legislative framework
- Consider whether a General Anti Avoidance Rule (GAAR) should form one element of strengthened defences. HMRC will engage informally with interested parties over the summer to explore whether there is a case for developing a UK GAAR.
- Immediate changes to ensure that a corporate investor cannot make use of an Authorised Investment Funds to create a credit for UK tax where no UK tax has been paid.

Life insurance taxation changes

- The Government will consult informally with industry on changes to the rules which govern transfers of life insurance business to ensure that an unintended tax charge does not arise when a UK life insurance company transfers long term insurance business to a non-EEA overseas company. The Government will legislate for this measure in a Finance Bill to be introduced as soon as possible after the summer recess.

Comment from Mark Penton, Director, Regulatory Consulting, Lansons Communications

The emergency Budget is, as expected, about ways of raising additional revenue to ease the sovereign debt burden that the country faces.

From a financial service perspective there are few, if any, surprises.

The banks are to be hit with a balance sheet levy from 2011. But everyone knew that was coming. Insurance Premium Tax increases were also widely anticipated making general insurance products more expensive at a time when the FSA's RDR policy is likely to increase the price consumers pay to be advised on purchasing investment products.

In the pensions space we have further uncertainty along with a recognition that things have to change in order to have a sustainable pension's framework for the future. Accelerating the increase in the state pension age to 66 is no surprise, nor is the consideration to be given to abolishing the maximum state pension age. It must be hoped that John Hutton's review of public sector pension provision opens up the opportunity for a renewed dialogue with the pensions industry about how a more sustainable public/private partnership can be created to provide a real solution to the pensions issues faced in this country.

Comment from Clive Booth, Director, Professional Services, Lansons Communications

The Chancellor demonstrated a soft spot for entrepreneurs and particularly those setting up business outside the South East. In the ten years to 2008 for every private sector job generated in the North and Midlands, ten were created in London and the South. A White Paper will be published in the summer setting out how to rebalance the economy across the country. In the meantime for the next three years anyone who sets up a new business outside London, the South East and the Eastern region will be exempt from up to £5,000 of employer national insurance payments, for each of their first 10 employees hired. It remains to be seen whether accountants will be able to advise their clients to financially domicile their firms outside the M25 whilst operating in the South East?

If the Treasury's estimates that some 400,000 businesses will benefit - ensuring all parts of the UK contribute to a more balanced and sustainable economic future – then hear, hear to that.

Political and stakeholder reaction

Harriet Harman, Leader of the Opposition

Harriet Harman QC MP, Leader of the Opposition said in response to the Budget statement:

“Today’s Budget is bad for growth and that will make it harder to cut the deficit. The new Office of Budget Responsibility has said in its report today, that because of this Budget, growth next year will be lower than it would have been under our policies to support the economy under difficult times.

“He said he was going to tell it straight, but the Chancellor has not told it straight today on jobs. Today’s Budget is bad for jobs and that too will make it harder to cut the deficit.”

Association of British Insurers (ABI)

Kerrie Kelly, Director General of the ABI, supports Osborne’s commitment to make the UK the most competitive location in the G20 by the end of this Parliament.

Kelly said: ‘The insurance industry applauds today’s focus on restoring the UK’s competitiveness. We are however disappointed to see the long-awaited Controlled Foreign Companies proposals have been further delayed. The rolling back on public spending announced today underlines a significant shift in the boundary between the public and private sector. The insurance industry stands ready to provide private insurance-based solutions: a 5per cent shift towards the private sector could save the Government and taxpayers £17 billion annually – more than the Budgets of the Home Office, Foreign Office and DEFRA combined.’

National Association of Pension Funds (NAPF)

Joanne Segars, NAPF Chief Executive, commented on the fact that the Chancellor said he would look at alternatives to restricting pension’s tax relief for those earning over £150,000.

Segars said: ‘We are pleased the Chancellor has listened to our argument for a much simpler and more radical solution. The previous Government’s proposals were a disaster in the making. They would have been very damaging to the pensions of all working people, not just the well-off. Reducing the amount that can be paid into a pension tax-free each year will protect the Treasury’s tax take, but will be much more supportive to pensions saving and less costly to implement. However, there is a lot of detail to be ironed out, and the level of the allowance is critical. We look forward to working with the Treasury to get the policy ready for implementation in April 2011.’

Confederation of British Industry (CBI)

Will Morris, Chair of the CBI Taxation Committee, commented on a strategy announced by the Chancellor in the Budget to simplify the corporate tax system, and bring down the headline rate of corporation tax in the medium-term.

Morris said: ‘The coalition’s roadmap for corporate tax sets a very positive course for the future direction of tax policy. This policy framework, combined with a strong process for business input, will reassure companies in the tough times ahead...It is clear that, despite the talented people involved, the tax policy-making process is simply not working as it should, from formation through to final

legislation. We welcome the Government's decision to consult on this in order to produce a better system for every stage of that process.'

The British Bankers' Association (BBA)

The BBA commented on the Budget, particularly on the announcement of the launch of a bank levy on all banks operating in the UK.

The BBA said: 'The UK is a trading nation and we must ensure bank taxes do not hurt our national interests or provide an unfair advantage for other businesses operating here. This levy is to apply to all major banks and building societies operating in the UK regardless of nationality. We are a large financial centre and a great many jobs are created here as a result. The industry does business globally but pays its taxes in Britain. The UK is not the only country creating some form of bank levy. So bank levies need to be co-ordinated internationally: they must not prevent the industry in the UK from being able to compete. It is essential that the international banks do not find themselves taxed multiple times for the same thing

Investment Management Association (IMA)

Julie Patterson, Director of Authorised Funds & Tax at the IMA, welcomed discussions on further improvements to competitiveness of UK funds.

Patterson said: "We welcome the Government's commitment in the Budget Report to consult with the industry on further improvements to the UK's fund tax regime...In order to compete more strongly for fund domicile business, the UK needs to offer tax-transparent contractual vehicles and to abolish the fund-specific and very low tax-generating Stamp Duty Reserve Tax regime. The UK could then capitalise on the growth opportunities being created by the UCITS Directive, which enables master-feeder funds to be marketed across Europe, and the Alternative Investment Fund Managers Directive, which is leading non-EU funds to consider relocating to Europe."

UNISON

Dave Prentis, the General Secretary of UNISON, accused the Government of declaring war on public services and public service workers with the most draconian budget in decades.

Prentis said: 'This Budget signals that the battle for Britain's public services has begun with the Government declaring war. Public sector workers will be shocked and angry that they are the innocent victims of job cuts and pay freezes... Throwing tens of thousands of public sector workers on the dole will cost the country billions in lost tax revenue as well as piling billions onto the benefits bill...The Chancellor dreams of a private sector recovery but how can that be on the back of brutal cuts to public services workers. Local businesses, shops, hairdressers, restaurants will go to the wall as spending dries up. No amount of fiscal stimulus will do any good if they have no customers.'

Unite

Derek Simpson, joint General Secretary of Unite called the Budget the biggest attack on essential services for a generation.

Simpson said: 'Where is the promised fairness in cutting the wages of needy households yet fighting shy of closing the tax loopholes which allow the wealthy to dodge their duty to this country? Increasing VAT is reckless - it will stop people spending, harm UK business and choke off the recovery.'

GMB

Paul Kenny, the General Secretary of GMB agrees with UNISON and describes the Budget as a 'demolition job on public services'.

Kenny said: 'This Budget is an almighty gamble. The Tory claim that there is an economic necessity to make these savage cuts is to turn the truth on its head. The fragile recovery underway places a duty on the Government to sustain demand in the economy to ensure growth. Getting back the 6per cent of national output that was lost due to this bankers recession is the only sure fire way of closing the gap between Exchequer income and expenditure. This was the Liberal Democrat policy too less than seven weeks ago. The lure of office has led to a Lib Dem change of policy to support this gamble which will result in hundreds of thousands of workers in both private and public sectors loosing their jobs and maybe give rise to a double dip recession. What a betrayal of the millions who voted for the Lib Dems.'

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