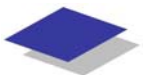
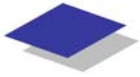


# **Pre-Budget Report 5 December 2005**

## **Summary of the Main Taxation Provisions**

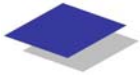
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### Introduction

#### Forced to acknowledge he got it wrong?

Today, Chancellor Gordon Brown was due to present his Pre-Budget Report, amid expectations that he will be forced to acknowledge the UK economy is slowing down. In the Budget earlier in the year, he predicted growth of 3-3.5%, but he has conceded a figure nearer to 2% may be more realistic. Independent forecasters have predicted the economy will grow by only 1.8%. The evidence is there on the High Street where confidence has fallen to its lowest level in at least 22 years, according to a recent survey by the CBI.

Already assured of a hostile reception to his speech, the stakes can seldom have been higher for the Chancellor as he prepared his pre-Budget report. Whilst he was expected to insist that his spending plans remain affordable, a rare admission of error would raise fears that he will have to put up taxes substantially or slash his plans. Mr Brown was also expected to set out measures to boost house building and help first-time buyers take part ownership of their homes.

#### What is the Pre-Budget Report?

A Pre-Budget Report (PBR) is delivered by the Chancellor to the House of Commons in the autumn. It provides a progress report on what has been achieved so far, gives an update of the state of the economy and public finances, and sets out the direction of Government policy in the run up to the spring Budget.

Chancellor Gordon Brown introduced the idea of a Pre-Budget Report (PBR) in 1997. Launching the first PBR on 26 November 1997, the Chancellor said that its aim was to "help build the foundations of shared understanding and sense of national economic purpose between government, business, and individuals."

The Treasury is legally bound to present two economic forecasts per year. Between 1993 and the 1997 election, this was done in the Budget which was held in November and the Summer Economic Forecast (late June/early July).

### Origins of the Budget

**Source:** HM Treasury

The origins of the Exchequer go back to the Norman period. The Norman system was based on two departments to deal with finance: the first, the Treasury, received and paid out money on behalf of the monarch; the second, the Exchequer, had a 'lower office' connected with the Treasury which received money, and it had an 'upper office', a court of law concerned with regulating the Kings accounts. The word 'exchequer' comes from the Latin 'scaccarium' meaning a chessboard. The name was given to the court because counters were moved on a square table. The word 'budget' comes from an old French word 'bougette' which means little bag.

### The idea was: No surprises

**Source:** AccountingWEB

Since presenting his first Budget statement in 1997, the Chancellor has raised the profile of the Treasury's autumn statement, turning the Pre-Budget Report into a consultative preview of his planned policies for the following spring. His approach has not completely eliminated unpleasant surprises such as IR35 or the 19% non-corporate distribution tax rate, but has given businesses and their advisers a little more time to digest new initiatives. This year, things have moved on apace. The 2005 Pre-Budget Report effectively began a week ago when the Chancellor told the Confederation of British Industry about his plans to cut red tape and make life easier for small businesses.

### Highlights

Mr Brown began his statement to MPs at 1531 GMT. The theme of the report was combining enterprise with investment in skills and science, with infrastructure in housing, to become a leader in the most wealth generating and dynamic industries. He said the world had faced inflationary pressures such as high oil prices, and the UK had taken action to slow rising house prices and consumer spending.

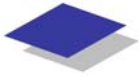
### Inflation Target

Mr Brown said that Britain was on course to meet its inflation target of 2%. He admitted this was the "toughest and most challenging year" for the British economy, but recession had been avoided.



#### Summary

This publication summarises the main proposals announced by the Chancellor on 5 December 2005. The information is derived from the many press releases issued by Government departments immediately after the Chancellor delivered his speech. Given the timescales involved in producing this publication only hours after the press releases became available, this is only a summary and is based on the press releases resourced by us on the day. Accordingly, there may be some proposals that are not covered here.



Growth this year was 1.75%, he said to Tory jeers about his prediction last year that it should be nearer 3-3.5%. The Chancellor forecast growth would be 2-2.5% in 2006.

### Employment

Employment was now 28.8m - the highest in the country's history, he said, and the numbers of adults with skills had risen from 79% to 86%. On average, workers change their jobs seven times during their working life. In eight areas of the country, teenagers currently getting no training will be offered training agreements.

### Housing

Turning to housing, the Chancellor said that Deputy Prime Minister John Prescott would be asking local authorities to bring forward more brownfield areas for development. He added that the long expected real estate investment trusts would be introduced to increase funding for new property developments. And, three of the biggest building societies and banks have joined the government to offer shared equity schemes to help first time buyers get on the property ladder.

### Budget Deficit

On the budget deficit, the Chancellor said it would fall from £19bn last year to £10bn this year and £4bn next year, before the books were balanced and surpluses arose.

The Chancellor added that net public investment which was £5bn in 1997, would this year be £26bn and £29bn next year.

### Security and Terrorism

The Chancellor promised an extra £135m for security and counter terrorism. There would also be an extra £580m for the armed forces and their work in Iraq and Afghanistan.

### Tax Credits

Mr Brown said he would overhaul the rules on paying out child tax credits to make them more flexible and take more account of changes in people's income.

### Property Planning Gains

The Government has introduced a consultative process in respect of planning gain taxation. If adopted this will result in a tax charge on part of the increase in land value when planning permission is obtained.

### Fuel Policy

The Chancellor said he would be enhancing capital allowances for the production of the most environmentally friendly bio-fuels. Ofgen will use its powers to intervene where necessary to ensure that gas importers either use or lose their capacity to import gas as Britain faces forecasts of a cold winter.

Mr Brown said petrol and road fuel taxes will be frozen for the whole of this financial year.

The winter fuel allowance for pensioners will continue for every year in this Parliament and be worth £300 for over 80s. The Government's "warm front" programme will offer free installation of central heating to old people on pensioner credit. All other pensioners will receive £300 towards the cost of installing central heating.

### Investment in Youth and Community Facilities

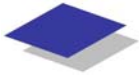
Unclaimed assets in bank accounts will be used to invest in youth and community facilities. There will be a new community youth service to help fund gap year students doing voluntary work in the UK. Each local authority will receive half a million pounds over the next two years to fund activities for young people.

### Britain meeting the Global Challenge: Enterprise, Fairness and Responsibility

The Government's economic objective is stated as being to build a strong economy and a fair society, where there is opportunity and security for all.

The press releases issued after the Chancellor sat down said that long-term decisions the Government has taken – giving independence to the Bank of England, new fiscal rules and a reduction in debt – have created a strong platform of economic stability. World growth in 2005, while still robust by historical standards, has moderated compared with 2004, in part due to a sustained rise in oil and petroleum product prices. This slowdown has been more pronounced among advanced economies, especially the UK's main export markets. Despite this, the UK economy continues its longest unbroken expansion since records began, with GDP now having grown for 53 consecutive quarters.





The global economy is undergoing a major transformation, with far-reaching and fundamental changes in technology, production and trading patterns. Faster information flows and falling transport costs are breaking geographical barriers to economic activity. This fast pace of change, combined with the emergence of rapidly industrialising economies such as China and India and their integration into the global economy, presents new opportunities for the UK as well as new challenges.

The response to globalisation requires action from businesses to respond to transformed markets and new opportunities, and action from government to establish the right business environment. The Pre-Budget Report sets out further reforms to support the UK's response to globalisation – including to increase the supply and improve the affordability of housing and strengthen the planning system, to reduce further the regulatory burden on business, to create a world-class environment for scientific research and development, and to improve the skills of the nation.

## Meeting the Productivity Challenge

The 2005 Pre-Budget Report sets out the next steps the Government is taking to drive productivity growth and meet the long-term challenges of the global economy, including:

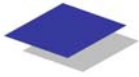
- ◆ taking forward the goals of the ten-year Science and Innovation Investment Framework with measures to create a world-class environment for health research, to enable the UK to maintain a leading role in stem cell research, and a strengthened partnership with the biomedical industry to increase private investment in medical R&D by up to £500 million in the short to medium term, rising to £1 billion per year in the medium to long term;
- ◆ setting out the Government's strategy for tackling the long-term lack of supply and responsiveness of housing, responding to Kate Barker's independent review of housing supply, and bringing forward Real Estate Investment Trusts to improve efficiency in the UK's commercial and residential property investment markets;

- ◆ building on the planning reforms already put in place by launching a review, led by Kate Barker, to consider how planning in England can better deliver sustainable economic development in a timely and transparent manner;
- ◆ progress implementing the recommendations of the Hampton Review to reduce the costs on business of administering regulations. HM Revenue and Customs (HMRC) will set a target for reducing administrative burdens in the tax system in Budget 2006 and, as a first step towards this target, plans have been announced for £300 million savings for business through reforms to tax administration;
- ◆ measures to reduce costs on business by removing unnecessary regulatory burdens including: the abolition of Operating and Financial Reviews for quoted companies; a ten-point action plan to reduce regulatory burdens in the financial services industry; greater consistency in local authority regulation and a review of gold-plated regulations derived from Europe;
- ◆ announcing an Independent Review, led by Andrew Gowers, to ensure that the UK's intellectual property framework is appropriate for the digital age;
- ◆ publishing the interim report of the Leitch Review of Skills advancing the evidence base on the UK's existing skills profile and highlighting the need for the UK to raise its ambition if it is to have a world-class skills base by 2020; and
- ◆ additional support for higher education exports to sustain the UK's world leading position and attract more highly skilled overseas students.

## Promoting Creativity

The Government has welcomed the recently published *Cox Review of Creativity in Business* and will be taking forward the recommendations it makes to the public sector. In particular, the Design for Business programme will be made available across the country by the Regional Development Agencies (RDAs), and the Higher Education Funding Council for England will lead the piloting of centres of excellence combining capabilities in business, engineering, technology and creativity as part of its Centres for Excellence in Teaching and Learning. The





Government has also considered the recommendations that Sir George Cox has made to the review of R&D tax credits and will be taking a number of them forward.

Sir George Cox will work with industry leaders from design, the arts and business and in partnership with the London Development Agency and other RDAs to develop plans for creativity and innovation centres in each English region, including a national hub in London.

### Promoting Flexibility Across the Regions

The Regional Development Agencies (RDAs) have been asked to contribute to the development of Budget 2006 on innovation, business support, and increasing private investment in economic development and regeneration, reflecting their role as strategic leaders of economic development.

The Pre-Budget Report also announced that an Independent Performance Assessment is being rolled out across the RDAs, with all results published by March 2007. This assessment will provide better public information about regional performance that helps improve regional accountability and scrutiny. Also announced today is a new RDA evaluation framework to improve the regional evidence base and provide information for the Comprehensive Spending Review in 2007.

Towards implementing Christopher Allsopp's recommendations in improving statistics for regional policy, the RDAs have agreed to work in partnership with the Office for National Statistics (ONS) to deliver a full regional statistical presence, by March 2007.







As a further step to increase regional and local input into policy, the Government recently published assessment criteria for local authorities to apply for Local Enterprise Growth Initiative funding. The deadline for submission of applications from local authorities and partners for financial support is 9 December 2005 and successful applicants will be announced in early 2006.

The Pre-Budget Report highlights the release of a consultation document on the London Mayor's powers, looking at options for increasing the Mayor's powers over key strategic functions in order to improve delivery outcomes for London.

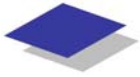
### Increasing Employment Opportunity For All

The Government's long-term goal is employment opportunity for all – the modern definition of full employment. Delivering this requires that everyone is provided with the support they need to participate in a successful labour market.

The 2005 Pre-Budget Report describes the steps the Government is taking towards its aim of employment opportunity for all, including:

-  extending the support offered through the New Deal Plus for lone parents (NDLP+) pilots, in the existing five locations for two years to 2008;
-  extension of the NDLP+ pilots to two further Jobcentre Plus districts in Scotland and Wales from October 2006;
-  outreach support for people who are neither in work nor on benefit;
-  introduction of a Commission of Business Leaders to advise on helping the private sector to tackle racial discrimination, building on NEP recommendations;
-  providing funding to ensure that all local authorities can take steps to reduce Housing Benefit fraud by reviewing or visiting at least 50 per cent of their claimants each year, in line with best practice; and
-  raising the earnings disregard in Housing Benefit and Council Tax Benefit in line with inflation to £14.90 per week in April 2006, ensuring that claimants gain from increases in the rates of Working Tax Credits.

Further details of measures to increase employment opportunity announced today are given on the next page.



### New Deal Plus for Lone Parents pilots (NDLP+)

The NDLP+ pilots are testing a more progressive model of active engagement for lone parents on benefit, based on clearer guarantees of advice and support. The Government announced today that it will:

- extend the support offered through the NDLP+ pilots in the existing five locations for a further two years, to 2008; and
- extend the NDLP+ pilots to two further districts in Scotland and Wales from October 2006.

### Implementing National Employment Panel recommendations

The Government today announced the implementation of two more of the National Employment Panel's recommendations on employment and small business growth for ethnic and faith minorities:

- new private and third sector led employment teams will be introduced to deliver outreach support for people who are neither in work nor on benefit; especially, the non-working partners of people in low income families, in groups which face particular barriers to employment, and
- a new Commission of Business Leaders will be asked to advise on helping the private sector tackle race discrimination in employment. The Commission will report to the Chancellor in early 2007.

## Building a Fairer Society

The Government said that it is committed to promoting fairness alongside flexibility and enterprise, to ensure that everyone can take advantage of opportunities to fulfil their potential. The Government's reforms of the welfare state reflect its aims of eradicating child poverty, supporting families to balance their work and family lives, promoting saving and ensuring security for all in old age. The Government is also committed to a modern and fair tax system that ensures everyone pays their fair share of tax.

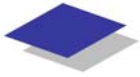
The Pre-Budget Report sets out the next steps the Government is taking to support these aims, including:






- an extension of Winter Fuel Payments paid at £200 for households with someone aged 60 or over, rising to £300 for households with someone aged 80 or over, for the rest of this Parliament;
- an additional £300 million over three years to enable pensioners on Pension Credit to have central heating systems installed free of charge, and to provide a £300 discount on all central heating systems to all other pensioners who do not already have one in their homes;
- investing £53 million over the next two years to improve services and support for families and children, including piloting new Parent School Advisors in over 600 primary and secondary schools
- a tax credits package to provide more certainty around tax credit awards while maintaining the flexibility to respond to falls in income and changes in circumstances;
- establishing an implementation body to take forward the Russell Commission recommendations on youth volunteering, with £3.5 million already committed from seven corporate Founding Partners;
- action to protect tax revenues and modernise the tax system, including a number of measures to tackle fraud, avoidance and tax-motivated incorporation;
- an increase in North Sea oil taxation, striking the right balance between promoting investment and ensuring fairness for taxpayers; and
- further steps to promote debt relief and international development, including the launch of the pilot International Finance Facility for Immunisation.

Further details are given below:

### Support for parents: the best start for children

Today the Government is publishing *Support for Parents: the best start for children* which assesses the progress made since 1977 in reforming the delivery of services for children and families. The Government announces that it is investing £53 million over the next two years to improve services and supports for families and children in the following areas:





-  piloting a new school-based outreach role - Parent Support Advisors - in over 600 schools, both primary and secondary;
-  a series of Single Account Holder Pathfinders in six to ten high-achieving local authorities to determine whether a budget-holding lead professional model might be implemented more widely;
-  a new pilot project to establish peer-mentoring schemes in 180 secondary schools over two years. This will deliver 3,600 matched mentor and mentee pairs;
-  a pilot mentoring scheme for 600 young looked after children aged ten to fifteen; and
-  an evaluation of new practices in local authorities for managing cases of children on the threshold of being taken into care.

### Tax credits: increasing flexibility and certainty



The Child and Working Tax Credits are central to the Government's programme of tax and benefit reform, and have brought about a step change in the way in which households draw support from the Exchequer. There are over 6.1 million families with 10.3 million children benefiting from tax credits. Initial estimates of take up suggest that, in its first year of operation, around 80 per cent of families eligible for the Child Tax Credit claimed it. This compares to 65 per cent in the first year of Working Families' Tax Credit, and 57 per cent in the first year of Family Credit.

Once fully implemented, the measures the Government announces today will mean that:

-  there will be greater certainty for claimants, particularly for families who see a rise in income;
-  in return, claimants will have clear responsibilities to report changes promptly and will be helped to keep their records up to date, including through more proactive contact by HM Revenue and Customs.

## North Sea Oil Tax Regime Reform

The Pre-Budget Report announces today reform of the North Sea oil taxation regime to strike the right balance between producers and consumers, by promoting investment and ensuring fairness to taxpayers. The measures include:

-  an increase in the rate of supplementary charge from 10 per cent to 20 per cent with effect from 1 January 2006;
-  an option for North Sea companies to elect to defer 100 per cent relief for capital expenditure incurred in 2005 into the following year; and a new Ring Fence Expenditure Supplement to uplift all expenditure by North Sea oil companies without taxable income to ensure that the value of the tax relief is maintained over time.

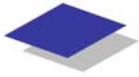
The Government is clear that there will be no further increases in North Sea taxation during the life of this Parliament.

Following discussions with industry, measures are announced today to change the way North Sea oil is valued and priced to achieve a fairer and less distortive tax pricing system. The measures, effective from 1 July 2006, are designed to ensure that companies pay tax on the full value of oil as it is delivered, eliminating tax driven behaviours that can distort commercial practice.

## Tackling Fuel Poverty

The Government will use additional revenue from the nation's North Sea oil resources to help consumers most affected by the significant increases in global oil and energy prices. Higher fuel and heating prices can cause particular problems for pensioners on fixed incomes. The Government will therefore use additional revenue from the North Sea to support pensioner households and to invest for the longer term in tackling fuel poverty.





The Government will extend the Winter Fuel Payments at the level of £200 for households with someone aged 60 or over rising to £300 for households with someone aged 80 or over for the duration of this Parliament.

To further assist pensioners with their heating costs, the Government announced today that it will set aside £300 million to enable pensioners on Pension Credit to have central heating systems installed free of charge, and provide a £300 discount on all central heating systems to all other pensioners who do not already have one in their home.

## Youth Volunteering

The Russell Commission report, published at Budget 2005, set out recommendations to deliver a step change in the diversity, quality and quantity of young people's volunteering, with an ambition of attracting one million more young volunteers over five years. Budget 2005 also announced public investment for this work of up to £100 million over the next three years.

An independent implementation body will be chaired by Rod Aldridge, currently chair of the Capita Group. The Government will also establish a cross-departmental Ministerial group on youth volunteering, chaired by the Chancellor, to support the work of the implementation body. The Pre-Budget Report also announced that £3.5 million has already been committed from T-Mobile, ITV, KPMG, MTV, Tesco, Sky, and The Hunter Foundation as Founding Partners.

Further details can be found at [www.russellcommission.org](http://www.russellcommission.org)

## Modernising the Tax System

A package of measures to reduce administrative burdens for small and medium-sized businesses, with changes to the tax regimes to help these businesses, were announced today. These further measures follow the speech made by the Chancellor to the CBI on 28 November 2005 and the publication by HMRC of *'Making the new relationship a reality'*.

Savings to businesses of around £300 million were announced which will arise from significant improvements to some key forms businesses identified as causing them most difficulty, improvements to the guidance, and new approaches to making the transfer of information to HMRC easier.

### Taxation of Small Business

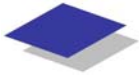
The zero per cent and minimum rates of corporation tax were introduced to encourage small companies to retain and re-invest their profits for growth. However many self-employed and employed people are being advised to incorporate simply to reduce their tax and national insurance liability.

The Government has considered the issue of continuing tax-motivated incorporation in the light of responses to its discussion paper issued in the 2004 Pre-Budget Report where most respondents favoured simplification over options which risked introducing additional complexity. The Government has therefore decided to replace the non-corporate distribution and zero per cent rates, with a new single banding set at the current small companies' rate of 19 per cent. This will simplify the corporation tax calculations for most small businesses, refocus incentives, and leave the small companies' rate at its lowest since its introduction in 1973.

To ensure that small businesses are provided with incentives to invest for growth, the Government will extend the first-year capital allowances to 50 per cent in the year from April 2006, benefiting 4.2 million small businesses.

And to assist more small traders with their cashflow, the Government will double the VAT Annual Accounting Scheme turnover threshold to £1,350,000, and has written to the European Commission for derogation to increase the Cash Accounting Scheme turnover threshold to the same level. Up to one million small businesses will be able to benefit from a range of more flexible payment options to suit their business needs.

The Government will continue to keep the structure of tax and national insurance contributions under review to ensure an appropriate balance between fairness for individuals and employers, incentives to work, save and invest, and reducing administrative burdens.



## Reform of Film Tax Incentives

British films form an important part of our cultural heritage. Following consultation, the Government today announces a package which will sustain the UK film industry's reputation for excellence in a globally competitive market.

Small budget films will receive an enhanced tax deduction of 100 per cent with a payable cash element of 25 per cent, amounting to a benefit worth at least 20 per cent of qualifying production costs. For qualifying co-productions spending at least 40 per cent in the UK, this represents a benefit of at least 10 per cent of total costs. Large budget films will receive an enhanced deduction of 80 per cent with a payable cash element of 20 per cent, amounting to a benefit typically worth 16 per cent of qualifying costs. Film production companies will be able to access this support when the new tax incentives come into effect from 1 April 2006.

Details of a new cultural test for British films are released today by the Department of Culture, Media and Sport. Further details of who is eligible for the relief, transitional rules and changes in the basic treatment of film expenditure will be published on HMRC's website.

The new incentives have been designed to be robust against abuse and avoidance. The Government continues to closely monitor the use of existing reliefs and will continue to take firm action to stop avoidance.

## Gambling Taxation

Following a comprehensive review of gambling taxation, announced in Budget 2004, the Government has concluded that the existing system remains appropriate for the industry going forward and will only be making changes to the taxation of gaming machines and remote gaming needed to align with the Gambling Act.

## Combatting Fraud and Tax Avoidance

A package of measures to combat tax fraud and avoidance have also been announced by the Chancellor today.

## Delivering High Quality Public Services

The Government's stated aim is to deliver world-class public services through sustained investment and ongoing reform. The 2004 Spending Review set outcome-focused targets and spending plans to 2007-08 that built on the increased resources delivered in previous spending reviews. The Pre-Budget Report confirms that the Government is on course to meet these targets.

The Pre-Budget Report outlines further measures directing resources towards the Government's public service priorities, including:

-  an additional £53 million to expand Youth Opportunity Funds, enabling young people to run their own projects and secure amenities and activities they want in each local authority. This will mean an average local authority receiving £500,000 over the next two years;
-  reallocating an additional £305 million in 2006-07 and £508 million in 2007-08 into grant for local authorities, enabling them to continue delivering high quality public services alongside low council tax increases;
-  providing an additional £85 million to advance the ongoing expansion of the security and intelligence agencies, and extending the availability of the £50 million Counter-Terrorism Pool beyond 2005-06; and
-  providing an additional £580 million for the special reserve in 2005-06 for military operations in Iraq and the UK's other international obligations.

The Pre-Budget Report sets out further details of the preparations for the 2007 Comprehensive Spending Review (CSR). A decade after the first CSR, the 2007 CSR will assess what the sustained increases in spending and reforms to public service delivery have achieved since 1997, identify what further investments and reforms are needed to equip Britain for the challenges of the years ahead.

Details are given on the next page.



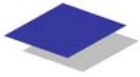
### Film Tax Relief Changes

Following consultation, the Government is applying the new film tax credit on 1 April 2006. It will apply to films beginning principal photography on or after that date and to films which start before then but are not completed by 1 January 2007 and, for film acquisition expenditure if the film is acquired before 1 October 2007.

The new regime is to apply to film production companies (FPCs) rather than to film producers. An FPC is a company responsible for the principal photography and post production stages of the film and for the completion of it.

The new treatment will apply only to companies and not to partnerships.

Film acquisitions will be included in the regime for Intellectual Property (from which they are currently excluded) under a more modern accountancy-based set of rules.




### Funding for Local Services

The Government is increasing the direct grant for local authorities by £305 million in 2006-07 and £508 million in 2007-08, reallocated from central programmes. By 2007-08, local authorities will have seen real terms increases in grant every year since 1997. This increased funding is supported by other measures to reduce pressures. Together, these steps will ensure that local authorities will be able to continue delivering high quality public services while ensuring that council tax rises are kept in line with those of the next two years, which have seen their lowest average increases for ten years.

### National Sports Foundation







As announced at Budget 2005, a National Sports Foundation will be established from April 2006, bringing public and private sectors together to invest in grass roots sport. The Government has committed £27.5 million over the next two years, and will be encouraging the private sector to match this funding, aiming to raise at least a further £30 million from private investors over this period. From 2006 this funding will be invested in three specific programmes to strengthen grass roots sport:

 **Fit for Sport** – projects to improve both physical and human infrastructure for community clubs. This programme will aim to provide up to ten new multipurpose pitches over the next five years and an extra 50 new sports coaches for the under 15s by 2008;

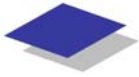
 **2012 Kids** – building on the success of the Olympics, projects to encourage children to take up sport, particularly in schools; and Women into Sport – projects to increase female participation in sport, including providing coaching and support for female teams.

## Protecting the Environment

The Government is committed to delivering sustainable growth and a better environment and to tackling the global challenge of climate change. The Pre-Budget Report sets out the Government's strategy for delivering a strong economy built on a sound environmental basis, and reports on recent and forthcoming actions to achieve this goal. These include:

-  support for alternative sources of energy including further consultation on carbon capture and storage, collaboration with Norway on this technology, and additional funding for Carbon Abatement Technology demonstration;
-  further measures to improve energy efficiency through the proposed Green Landlord Scheme and £35 million for the Carbon Trust to provide interest free loans for the introduction of energy saving measures;
-  continuation of the freeze in main fuel duty rates and the duty rates for road fuel gases, due to continued oil market volatility; and a 1.22 pence per litre increase in duty on rebated fuels, which will support the strategy to tackle oils fraud;
-  a commitment to introduce a Renewable Transport Fuel Obligation and Enhanced Capital Allowances for the cleanest biofuels plants, to stimulate the development of alternative fuels;
-  in support of the UK's continuing leadership in addressing the international challenge of climate change, progress on taking forward the Gleneagles Plan of Action agreed by the G8 under the UK's Presidency and the Stern Review on the economics of climate change; and
-  progress towards the inclusion of the aviation sector within the EU emissions trading scheme.

Further details of measures to protect and enhance the environment are set out on the next page.



### Climate change and energy efficiency

#### Support for alternative energy technologies and low carbon energy sources:

Carbon abatement technologies - including carbon capture and storage (CCS) - could potentially make a significant contribution to reducing carbon emissions both domestically and globally while also promoting energy security and reliability. The Government announced today further support for alternative energy technologies including:

- working collaboratively with Norway on the issues surrounding the costs of CCS and possible economic incentives;
- consultation on the barriers to wide-scale commercial deployment of CCS in the UK and the potential role of economic incentives in addressing those barriers;
- providing additional funding of £10 million for demonstrations under DTI's Carbon Abatement Technology Strategy; and
- further support for microgeneration technologies through the extension of reduced VAT rates for the installation of wood-fuelled boilers.

#### Measures to improve energy efficiency:

The Government continues to encourage energy efficiency as the most cost effective way for individuals and business to reduce both energy costs and carbon emissions and today announces:

#### Alternative transport fuels:

At the 2004 Pre-Budget Report, the Government announced a feasibility study and consultative process on a possible Renewable Transport Fuels Obligation (RTFO). An RTFO would require transport fuel suppliers to ensure that a percentage of their sales are from a renewable source, and could deliver significant carbon reductions from road transport, while supporting the Government's air quality and diversity of supply objectives.

#### Reform of Wear and Tear Allowances:

The Government announced its intention to reform the existing Wear and Tear Allowance by making it conditional on the energy efficiency level of the property; for the business and public sectors, £35 million for the Carbon Trust to provide loans for the

introduction of energy saving measures; ongoing discussions between Government and business to further examine the steps required to improve investment in energy efficiency.

The Government will now go ahead with an RTFO, expected to be launched from April 2008, with a target level of 5 per cent in 2010-11. The Government today announces that discussions with stakeholders will be undertaken over the next three months to inform the decision on the target level for the RTFO in 2008-09 and 2009-10, with the levels set out in Budget 2006, along with the duty level for 2008-09. Further consultations on the detail of the RTFO will be taken forward over the next 12 to 18 months.

#### Enhanced Capital allowances (ECAs) for biofuels:

The Government also announced that, subject to State Aid approval, it will go ahead with a 100 per cent first year ECA for biofuels plant that meet certain qualifying criteria, which make a good carbon balance inherent in the design. The ECA will work alongside the RTFO, and add value by creating an additional incentive for the most environmentally beneficial production of biofuels in the UK. The Government anticipates that the scheme will be introduced in 2007 subject to State Aid approval.

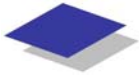
#### Fuel duties:

In response to the continued volatility in oil markets, the Government is continuing the freeze in main fuel duty rates until Budget 2006. Duty rates for road fuel gases are also frozen until Budget 2006.

To support the UK Oils Strategy and reduce incentives for fraud, the Government today announces an increase of 1.22 pence per litre in duty on rebated gas oil. The Government also announces a 1.22 pence per litre increase in heavy fuel oil to take account of the polluting nature of the fuel.

#### Haulage industry:

The Government welcomed the report of Burns inquiry into the impact of fuel duty and competition from overseas on the UK haulage industry. It recognises that there are also a number of other important challenges facing the haulage industry and is therefore inviting key industry associations to participate in a joint task group to place the findings of the inquiry in this broader



context. The task group will also assess how the pressures identified by the Burns inquiry compare with those facing other sectors which are open to international competition or have experienced rising input costs.




## Protecting Tax Revenues

A package of measures aimed at tackling tax fraud and avoidance was announced by the Chancellor today. These measures will protect the tax system from abuse and ensure that an unfair burden does not fall on the vast majority of taxpayers who pay their fair share.

The measures, which will protect revenue for investment in public services, are targeted at tax fraud and avoidance. Many of the measures have been informed by the disclosure rules introduced in Finance Act 2004, which allow HM Revenue and Customs (HMRC) to identify and target specific risks to the tax system. The package includes an announcement, building on the success of the disclosure rules, to ensure the disclosure rules will continue to enable HMRC to identify and tackle risks as they arise.

### Disclosure Regime

To build on the success of the disclosure regime, introduced in Finance Act 2004, the Pre-Budget Report announces:

-  proposals to improve the effectiveness of the 'filters' for direct tax to ensure they reflect recent developments in avoidance behaviour;
-  the extension of the regime to cover avoidance risks across all of income tax, corporation tax and capital gains tax, allowing HMRC to take further targeted action against avoidance while minimising burdens for the compliant; and
-  that businesses will be required to provide information on direct tax schemes and arrangements devised 'in-house', within 30 days of implementation, bringing them more in line with the rule for promoters.

HMRC will be discussing the changes with stakeholders. The changes will be effective from April 2006 and will allow HMRC to continue to respond swiftly and proportionately to tax avoidance.

## Other Tax Changes

### Sale of lessor companies

In response to increasing tax-driven activity in this area, changes have been announced to the way that lessor companies are taxed when they change ownership. Groups have benefited from capital allowances in the early years of a lease, before selling lessor companies to loss-making groups to avoid paying tax on the subsequent profits.

This measure, effective from 5 December, imposes a charge on the leasing company on the day that it is sold in order to recover the tax benefits that have been taken, and grants an equal relief on the day after the sale. It should not deter commercially driven sales.

### Corporate capital losses

Targeted anti-avoidance rules will be introduced with effect from 5 December to ensure that capital losses can only be created and used as a result of genuine commercial transactions. This responds to information received under the disclosure regime highlighting transactions artificially structured to gain a tax advantage. The introduction of rules with a more purposive-based approach will enable the repeal of some existing mechanical provisions.

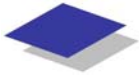
### Financial avoidance using stock lending arrangements

A scheme reported under the disclosure rules that allows companies or persons to avoid tax on interest using a stock lending arrangement will be blocked. This measure is targeted at avoidance of tax on interest on cash deposits, using a stock lending arrangement with non-commercial terms.

For arrangements entered into from 5 December, the taxpayer will be treated as receiving interest at a commercial rate on their cash.

### Taxation of corporate intangible assets

With effect from 5 December 2005, avoidance schemes involving corporate intangible assets will be blocked.



Groups of companies have been using schemes to artificially generate tax relief by moving rights in existing intangible assets around a group. This measure will ensure the regime for intangible assets functions as was intended at its introduction in 2002.

### Capital gains: policies of insurance

The tax rules for capital gains will be changed to clarify that capital losses arising on disposals of certain insurance policies, including capital redemption policies, cannot be deducted from capital gains in order to reduce or eliminate liability to tax. The changes respond to information received under the disclosure rules and are effective from 5 December.

### Transfer of assets abroad

Action is being taken to stop UK-resident individuals avoiding tax by exploiting offshore companies and trusts. Changes to the transfer of assets abroad legislation will tighten the rules for exemption from liability and close loopholes with effect from 5 December.

### Inheritance tax avoidance

Targeted anti-avoidance measures to tackle contrived inheritance tax (IHT) avoidance schemes will take effect from 5 December. These measures are designed to counter:

- avoidance involving second-hand interests in foreign trusts; and
- the use of artificial trust arrangements to escape both the IHT "gift with reservation" rules and the "pre-owned assets" income tax charge.

### Missing Trader Intra-Community (MTIC) VAT Fraud

The Government says that it is determined to tackle MTIC fraud, and the criminals perpetrating it, and is taking steps to strengthen its strategy. HMRC is intensifying its operational activities throughout the UK and its cooperation with other countries to combat this fraud. In addition the Government will not hesitate to bring forward further legislation if necessary.

### Tobacco smuggling

New initiatives to build on the success of HMRC's strategy for tackling tobacco smuggling have been announced, including:

- enhanced agreements between HMRC and tobacco manufacturers, which will further restrict the availability of tobacco to smugglers;
- consultation on new measures to strengthen protection for consumers from counterfeit tobacco; and
- a new approach to tackling smuggling of hand-rolling tobacco (HRT), involving new legislation to impose better controls on the supply chain for HRT plus the deployment of 200 staff to underpin these new controls.

### Oils fraud

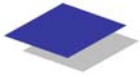
To strengthen further the UK oils strategy, the Government today announced an increase in duty rate for rebated gas oil ('red diesel') of 1.22 pence per litre (ppl). The change, which takes effect from midnight, 5 December, will narrow the differential with main duty rates, reducing incentives for fraud. The Government's oil strategy aims to reduce oils fraud from 6 per cent of the Great Britain diesel market in 2001 to no more than 2 per cent by March 2006.

Changes to the categories and definitions of those vehicles eligible to use rebated oils are also announced, which will improve clarity and reduce the scope for unintended revenue leakage. A summary of responses to the consultation launched at the 2004 Pre-Budget Report is also published today.

Exchange of information on indirect taxes & ratification of OECD/Council of Europe Convention on Mutual Administrative Assistance.

Bilateral agreements with non-EU countries regarding the exchange of information on indirect taxes and the ratification of the Council of Europe OECD 1988 Convention on Mutual Administrative Assistance in Tax Matters will be sought by the UK.

These changes will complement Government's promotion of exchange of information as an effective means of tackling avoidance and evasion of direct taxes.



## UK Real Estate Investment Trusts (REITs)

Following Kate Barker's recommendation, the Pre-Budget Report announces that the Government will bring forward draft legislation to establish UK-REITs for inclusion in the 2006 Finance Bill. Details of the tax proposals will be published by HM Revenue and Customs before the end of 2005 and will include the following key features:

- the regime will be open to companies, resident in the UK, that are publicly listed on a Recognised Stock Exchange;
- companies or groups that meet the UK-REIT eligibility criteria as set out in legislation will not pay corporation tax on qualifying property rental income or qualifying chargeable gains; and
- a requirement to distribute at least 95 per cent of net taxable profits on rental income to investors, who will then pay tax at their marginal rate.

The Government says that it is committed to ensuring no overall loss of revenue from the introduction of UK-REIT legislation and will announce at Budget 2006 final details of the conversion charge applying to companies joining the regime.

## The Leitch Review Skills in the UK: The long term challenge

Lord Leitch, publishing his interim report, said:

"Skills present a formidable challenge and a brilliant opportunity. They matter fundamentally for the economic and social health of the UK. Despite recent improvement, there is consensus that we need to be much more ambitious and a clear message that the UK must raise its game. This is an urgent task. The scale of the challenge is daunting. Delivering current plans will be difficult. Even then, it will not be enough to supply the skills that employers, employees and our nation needs in order to advance. The UK must become world class on skills – for all of our sakes."

The Report finds that, over the last decade, the skills profile of the UK has improved because of an excellent higher education system; reforms to vocational training and an increasingly effective schools system. But the UK has much further to go:

- over a third of adults of working age in the UK do not have a basic school leaving qualification;
- five million adults have no qualifications at all; and
- one in six adults do not have the literacy skills expected of an 11 year old and half do not have these levels of functional numeracy.

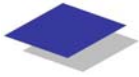
The UK is in a strong position with a stable and growing economy and world-leading employment rates. However, UK productivity continues to trail many international comparators and poor skills continue to have a direct effect on social inequality.

Looking ahead to 2020, existing targets mean that skill levels are set to improve with significant reductions in people without qualifications and increases in adults holding a degree. However, the Report concludes that, even though these ambitious targets will be very difficult to achieve, the UK's skills levels will continue to compare poorly in an increasingly globalised world. There is a risk that this will undermine the UK's long-term prosperity.

The Review analyses some ambitious scenarios for 2020 that tackle the stock of low skilled adults without qualifications, invest more in intermediate skills or further increase the proportion of adults with a degree. All show significant economic and social benefits resulting from higher productivity or employment levels through improving skills.

The Chancellor highlighted the importance of this report, and said:

"To become world leaders in any sector we must become world leaders in education. All of us know that as global restructuring moves mass production to other areas, the UK's future success will be founded upon high levels of skills. I thank Lord Leitch for this work. With these conclusions a national debate will lead to decisions about our vocational training goals for the future."



## Personal Allowances etc

All income tax allowances will automatically be increased in line with inflation. The personal allowance will increase to £5,035.

The age-related personal allowances will rise to £7,280 for people aged between 65 and 74 and to £7,420 for those aged 75 and over. This will mean that in 2006-07 no one aged 65 or over need pay tax on an income of up to £140 a week. Around half of all pensioners pay no tax on their income.

What is yet to be confirmed (to be decided in the 2006 Budget) includes:



Basic and Higher Rate Income Tax Rates



Threshold for Higher Rate Income Tax



Capital Gains Tax Threshold

Income tax personal and age-related allowances 2006-2007	£
Personal allowance (age under 65)	5,035
Personal allowance (age 65-74)	7,280
Personal allowance (age 75 and over)	7,420
Married couple's allowance* (aged less than 75 and born before 6 April 1935)	6,065
Married couple's allowance* (age 75 and over)	6,135
Married couple's allowance* – minimum amount	2,350
Aged income limit	20,100
Blind person's allowance	1,660
* Married couple's allowance given at the rate of 10%	

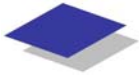
## National Insurance

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

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

Increases in the NI Contribution thresholds are set out in the Table below. The rates are unchanged.

NIC Contributions 2006-07	
Lower earnings limit, primary class 1	£84 a week
Upper earnings limit, primary class 1	£645 a week
Primary threshold	£97 a week
Secondary threshold	£97 a week
Employees' primary class 1 rate	11% on £97 to £645 a week 1% above £645 a week
Employees' contracted-out rebate	1.6%
Married women's reduced rate	4.85% on £97 to £645 per week 1% above £645 a week
Employers' secondary class 1 rate	12.8% on earnings above £97 a week
Employers' contracted-out rebate, salary-related schemes	3.5%
Employers' contracted-out rebate, money-purchase schemes	1%
Class 2 rate	£2.10 a week
Class 2 small earnings exception	£4,465 a year
Special class 2 rate for share fishermen	£2.75 a week
Special class 2 rate for volunteer development workers	£4.20 a week
Class 3 rate	£7.55 a week
Class 4 rate	8%
Class 4 lower profits limit	£5,035 a year
Class 4 upper profits limit	£33,540 a year
Class 4 rate above upper profits limit	1%



## Tax Credits

### Child and Working Tax Credit rates and Child Benefit

Child Benefit is raised in line with inflation, except for the lone parent element, which remains frozen.

The child element of Child Tax Credit (CTC) increases in line with average earnings. The disabled child element and severely disabled elements rise with inflation. The family element (normal and baby addition) remains frozen at £545 per year. The income threshold for CTC only rises to £14,155 per year. The income threshold for CTC family element only remains at £50,000 per year.

The maximum eligible childcare costs remains at £175 for one child and £300 for two or more children. The percentage of eligible childcare costs increases from 70 per cent to 80 per cent.

The disregard in Tax Credits for increases in income between one tax year and the next rises from £2,500 to £25,000 from April 2006.

### Research & Development (R&D) Tax Credits

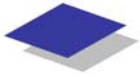
On 2 December 2005, HMRC and HM Treasury published *"Supporting Growth in Innovation: the Next Steps for the R&D Tax Credits"*.

The publication dealt with the implementation of a package of measures to improve the delivery and administration of the R&D Tax Credit.

In addition, the Government will review whether there is a case to further enhance the support available through the SME Tax Credit and any conclusions will be announced in Budget 2006.



£ per year (unless stated)	2005-06	Change	2006-07
<b>Working Tax Credit</b>			
Basic element	£1,620	+£45	£1,665
Couple and lone parent element	£1,595	+£45	£1,640
30 hour element	£660	+£20	£680
Disabled worker element	£2,165	+£60	£2,225
Severe disability element	£920	+£25	£945
50+ Return to work payment (16-29 hours)	£1,110	+£30	£1,140
50+ Return to work payment (30+ hours)	£1,660	+£45	£1,705
<b>Childcare element of the Working Tax Credit</b>			
Maximum eligible cost for one child	£175 per week		£175 per week
Maximum eligible cost for two or more children	£300 per week		£300 per week
Percentage of eligible costs covered	70%	+10%	80%
<b>Child Tax Credit</b>			
Family element	£545		£545
Family element, baby addition	£545		£545
Child element	£1,690	+£75	£1,765
Disabled child element	£2,285	+£65	£2,350
Severely disabled child element	£920	+£25	£945
<b>Income thresholds and withdrawal rates</b>			
First income threshold	£5,220		£5,220
First withdrawal rate (per cent)	37%		37%
Second income threshold	£50,000		£50,000
Second withdrawal rate (per cent)	6.67%		6.67%
First threshold for those entitled to Child Tax Credit only	£13,910	+£245	£14,155
Income disregard	£2,500	+£22,500	£25,000



## Child Benefit and Guardian's Allowance

The rates of Child Benefit and Guardian's Allowance for 2006-07 will be as set out opposite.

£ per week	2005-06	Change	2006-07
Eldest/only child	£17.00	+£0.45	£17.45
Other children	£11.40	+£0.30	£11.70
Eldest/only Child (Lone Parent Rate)	£17.55		£17.55
Guardian's Allowance	£12.20	+£0.30	£12.50

## Pensions Tax Simplification

From 6 April 2006, a single universal regime for tax-privileged pension savings will be introduced. The new regime will provide individuals with greater flexibility and choice over their retirement savings. To prevent potential abuse of the new regime, the Government has today announced that:

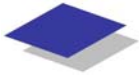
- Self Invested Personal Pensions (SIPPs) and all other forms of self-directed pensions will be prohibited from obtaining tax advantages when investing in residential property and certain other assets, such as fine wines, from 6 April 2006. This action will ensure that tax relief is only given to those whose purpose in making the contribution is to provide themselves with a secure retirement income; and
- action will also be taken to prevent abuse of the rules for tax-free lump sums from 6 April 2006. The legislation will remove tax advantages where lump sums are recycled back into funds in order to generate artificial levels of tax relief.

To encourage investment in a range of assets as part of pensions saving, the Government is minded to allow SIPPS to invest in genuinely diverse commercial vehicles that hold residential property, such as the proposed Real Estate Investment Trust model. Action will be taken if it becomes apparent that people are trying to use collective vehicles to get around the rules for prohibited assets. HMRC has today published detailed technical guidance on the prohibition.

### The Chancellor has changed his mind

In a dramatic U-turn in the existing primary legislation - direct or indirect investment in individual residential property will not, after all, be permitted from April 2006. And, most forms of alternative investments will be prohibited and a draconian tax charge will apply to any pension fund that dares to invest in these "prohibited assets". The Technical Note from HMRC even goes so far as to explain the potential 70% tax charge that will be applied.

The new legislation to amend the new legislation will remove all tax advantages from holding so called "prohibited assets" directly or indirectly (that means you can't use a limited company to buy the property and hold the shares in a SIPP or SSAS). In short, pension schemes will be penalised for holding in residential property in the UK or abroad. Having brought primary legislation in the Finance Act 2005 and the regulations that go with it, the Government have changed the rules at the last minute.



## Capital Gains Tax (CGT)

The Chancellor made no new announcements and the favourable rates of taper relief on business assets remain as follows:

Whole years Asset held from 6 April 1998		
	Percentage of gain charged to tax	Effective rate of tax for higher rate taxpayer (%)
Less than 1	100	40
1	50	20
2	25	10

## Cars

The car benefit charge for a full year is obtained by multiplying the price of the car for tax purposes (in most cases, its list price plus accessories less capital contributions) by the 'appropriate percentage'. A more detailed guide is available for employees in the IR203 self assessment helpsheet

([www.hmrc.gov.uk/helpsheets/ir203.pdf](http://www.hmrc.gov.uk/helpsheets/ir203.pdf))

and for employers in booklet 480

([www.hmrc.gov.uk/guidance/480.pdf](http://www.hmrc.gov.uk/guidance/480.pdf)).

### Changes to the car benefit rules in 2006/07

The appropriate percentage is based on the car's approved CO2 emissions figure. There are some supplements and reductions to take account of different fuels. The rules governing the supplements and reductions change with effect from 2006/07. The following Table summarises the new rules from 2006/07:

Type of fuel	Code	Standard adjustment	Other adjustments
Petrol	P	none	none
Diesel (not Euro IV)	D	supplement: 3% (see note 1)	none
Diesel (Euro IV) first registered on or before 31 December 2005	L	cancel type D supplement, above	none
Diesel (Euro IV) first registered on or after 1 January 2006	L	supplement: 3% (as type D; see note 1)	none
Electric only	E	reduction: 6%	none
Hybrid electric	H	reduction: 3%	none
Gas only	B	reduction: 2%	none
Bi-fuel with CO2 emissions figure for gas (note 2)	B	reduction: 2%	use lowest CO2 figure
Bi-fuel conversion, or other bi-fuel not within type B	C	none	none

#### Notes

1. Subject to the overall maximum appropriate percentage of 35%.

2. Cars which were type approved as bi-fuel cars and were first registered on or after 1 January 2000. These cars have two approved CO2 emissions figures, one each for petrol and gas (though only one may appear on the Vehicle Registration Certificate, V5C).

Supplements and reductions only apply to cars first registered on or after 1 January 1998. They apply to all such cars, whether or not they have an approved CO2 emissions figure.

### Summary of the changes to the 2005/06 rules

The changes are:



types B and H: standard reduction increased by 1% each (to 2% and 3% respectively) but the extra adjustment for very low CO2 emission cars no longer applies



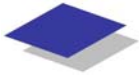
type C: reduction no longer applies



type L: supplement for type D cars also applies to type L cars first registered on or after 1 January 2006.

The changes will be incorporated into the HMRC website car and car fuel benefit calculator when it is extended to cover 2006/07. The previous rules continue to apply to all years from 2002/03 to 2005/06, so those years will be unaffected. The changes to the calculator will be made after the 2006 Budget.





## Fuel Duty

The Pre-Budget Report announces the continuation of the freeze in main fuel duty rates and the duty rates for road fuel gases, due to continued oil market volatility.

To help reduce incentives for oils fraud, the Government today announces that the duty on rebated gas oil will increase by 1.22 pence per litre. Duty on heavy fuel oil will also increase by 1.22 pence per litre, to reflect the polluting nature of the fuel. The increases take effect from midnight on 5 December 2005.



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Publication issued on: 21 December 2005

Ref: 725

Pence per litre (unless stated)	Old duty rate	Change	New duty rate
Ultra-low sulphur petrol/diesel	47.1p	-	47.1p
Sulphur-free petrol/diesel	47.1p	-	47.1p
Biodiesel	27.1p	-	27.1p
Bioethanol	27.1p	-	27.1p
Liquefied petroleum gas used as road fuel	9p per kg (equivalent 5.4p per litre)	-	9p per kg
Natural gas used as road fuel	9p per kg (equivalent to 6.1p per litre)	-	9p per kg
Rebated gas oil (red diesel)	5.22p	+1.22p	6.44p
Fuel Oil	4.82p	+1.22p	6.04p

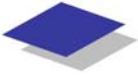
## Inheritance Tax (IHT) Thresholds

The Chancellor has already announced the threshold for IHT:

-  2006/07 = £285,000
-  2007/08 = £300,000

## Further Information

If you would like to receive further information about this subject or other publications, please call us – see our contact details on the next page.



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