

The Government is committed to promoting fairness alongside flexibility and enterprise so that everyone can take advantage of opportunities to achieve their full potential in a modern, flexible economy. The reforms of the welfare state introduced by this Government reflect its aims of eradicating child poverty, work for those who can and ensuring security for all in old age. The Government is also committed to a modern and fair tax and benefit system which encourages work and saving and ensures that everyone pays their fair share of tax. This Budget sets out the next steps the Government is taking to support these aims, including:

- **reforming financial support for 16 to 19 year olds**, to increase the proportion of young people who reach the age of 19 equipped with the skills they need to succeed in a modern global economy;
- **additional funding for Sure Start, early years and childcare of £669 million in 2007-08** compared with 2004-05, an average annual real growth rate of 17.3 per cent;
- **a Children's Centre in all of the 20 per cent most disadvantaged wards in England by 2008**, moving towards the goal of a Children's Centre for every community;
- **a £100 payment to pensioner households with someone aged 70 or over to help with their council tax bills**;
- **simplifying the taxation of pensions**, replacing the complexity of eight existing regimes with a single, simplified regime with a lifetime allowance for tax-privileged pension saving;
- **promoting financial inclusion**, focusing on helping households access affordable banking and credit;
- **taking action to protect tax revenues and modernise the tax system**, including measures to combat tax fraud and avoidance; and
- **implementing the O'Donnell review recommendations to establish a new customer-focused tax service**, integrating the Inland Revenue and HM Customs and Excise.

## INTRODUCTION

**5.1** The Government's aim is to build a strong economy and a fair society, where there is opportunity and security for all. The Government is committed to ensuring flexibility and fairness are advanced together, so that everyone can achieve their full potential in a modern, dynamic economy.

**5.2** The Government's strategy for delivering strong and stable growth centres on a robust macroeconomic framework and reforms which promote a flexible economy with a skilled workforce and high levels of employment. The principles of opportunity, responsibility and security underpin the welfare state. Ensuring employment opportunity for all, set out in Chapter 4, is central to avoiding poverty and provides the best platform from which to save for security in retirement. This chapter describes the action the Government is taking to put into practice the principle of progressive universalism, providing security through support for all and more help for those who need it most, when they need it most.

**5.3** The chapter sets out the steps the Government is taking to tackle child and pensioner poverty, promote saving and ensure security for all in old age. It describes the action the Government is taking to promote a modern and fair tax system, to close tax loopholes and to tackle fraud. The chapter also sets out the Government's strategy for achieving the Millennium Development Goals to reduce global poverty.

## SUPPORT FOR FAMILIES AND CHILDREN

### Tackling child poverty

**5.4** Every child deserves the best start in life, with opportunities to develop their full potential and lead fulfilling lives. In the mid to late 1990s, the UK suffered higher child poverty than nearly all other industrialised nations. Over a period of 20 years, the proportion of children in relative low-income households had more than doubled. The Government therefore set an ambitious long-term goal to halve child poverty by 2010 and eradicate it by 2020.

**5.5** Poverty is not just about income. The Government's strategy for tackling child poverty involves a broad range of measures to improve children's lives in the short term and, over the long term, to break cycles of deprivation. The strategy comprises: ensuring decent family incomes, with work for those who can and support for those who cannot; supporting parents in their parenting role; delivering high quality public services; and working with the voluntary and community sectors.

**Progress to date 5.6** The first step towards the Government's long-term goal is the Public Service Agreement (PSA) target to reduce by a quarter the number of children in low-income<sup>1</sup> households between 1998-99 and 2004-05. The most recent data show that, between 1998-99 and 2001-02, the numbers of children in relative low-income households fell by 0.5 million before housing costs (BHC) and by 0.4 million after housing costs (AHC), from 3.1 million and 4.2 million respectively.<sup>2</sup> The Government has therefore succeeded in arresting and reversing the long-term trend of rising child poverty and is making steady progress towards the 2004-05 PSA target. In addition, between 1998-99 and 2001-02, the number of children in absolute low-income households fell from 2.8 million to 1.6 million BHC and from 4.0 million to 2.5 million AHC.

**Meeting the child poverty target 5.7** These data do not reflect the increased support for families with children provided through the introduction of new tax credits in April 2003, nor the £180 a year increase in the child element of the Child Tax Credit (CTC) announced in the 2003 Pre-Budget Report. This additional investment of almost £1 billion, on top of uprating by inflation, will benefit 7.2 million children in 3.7 million families. The investment in financial support for families, combined with continued progress against the Government's employment targets, means that the Government is on track to meet or exceed its PSA target on a BHC basis. Achieving the target is less certain on an AHC basis. The nature of the target means there are uncertainties either way. Analysis by the Institute for Fiscal Studies suggests that the Government is on course to meet the target comfortably on a BHC basis and to just meet the target on an AHC basis.<sup>3</sup> The IFS acknowledges the uncertainties in making these forecasts.

<sup>1</sup> Low-income is defined as less than 60 per cent of contemporary median income. Income is defined as household disposable income, adjusted for household size and composition. The target is measured on both a before housing costs and after housing costs basis to take into account variations in housing costs that do not correspond to comparable variations in housing quality.

<sup>2</sup> Data from *Households Below Average Income 1994-95 to 2001-02*, Department for Work and Pensions, March 2003. Data for 2002-03 will be published on 30 March 2004.

<sup>3</sup> *Will the Government hit its child poverty target in 2004-05?*, M. Brewer, Institute for Fiscal Studies, Briefing Note No.47, March 2004.

**Long-term measure of child poverty** **5.8** As the Government moves towards its long-term goal of eradicating child poverty, it is important that the way child poverty is measured helps target policies effectively and enables the public to hold the Government to account. In December 2003, the Department for Work and Pensions published the new long-term measure of child poverty,<sup>4</sup> which consists of three tiers:

- absolute low income – to measure whether the poorest families are seeing their incomes rise in real terms;
- relative low income – to measure whether the poorest families are keeping pace with the growth of incomes in the economy as a whole; and
- material deprivation and low income combined – to provide a wider measure of people's living standards.

**5.9** This measure provides the right balance between clarity and comprehensiveness. Using this measure, poverty is falling when all three indicators are moving in the right direction. Applying the new measure, the Government will continue to judge progress towards halving child poverty by 2010 against relative low income alongside the new measures on material deprivation and absolute low income. The specific PSA targets to achieve this will be set as part of future Spending Reviews.

**The Child Poverty Review** **5.10** The Government remains determined to make progress beyond 2004-05 and recognises that further investment and reform are needed to meet the goals of halving and then eradicating child poverty. The Child Poverty Review, announced in Budget 2003, is addressing this. It is discussed further in Box 5.1. The results of the review will feed into the 2004 Spending Review and beyond.

## Financial support for children

**5.11** The Government's approach to financial support for children is based on the principle of progressive universalism, with help for all families and more help for those who need it most. Support is delivered through the combination of universal Child Benefit and progressive Child Tax Credit (CTC). The CTC provides an integrated system of income-related support for families which is independent of the parents' work status, bridging the gap between welfare and work.

**5.12** By the end of January 2004, the new tax credits were benefiting six million families, including those receiving support through the child allowances in their benefits, meeting the Government's ambitious expectations for the number of beneficiaries in 2003-04 after just ten months. The tax credits are reaching far more low and moderate-income families than any previous system of income-related financial support.

**5.13** By 2004-05, financial support for children through tax credits, Child Benefit and other benefits will have increased by £10.4 billion in real terms from its 1997 level, a rise of 72 per cent. The 2003 Pre-Budget Report announced **a significant rise in the child element of Child Tax Credit – up £180 to £1,625 a year from April 2004**. Table 5.1 shows the levels of support that the CTC and Child Benefit will provide for families from April 2004. The amount a family receives depends on its income and circumstances. For example, a family with a disabled child or eligible childcare costs receives more support for a given level of income.

<sup>4</sup>Measuring child poverty, Department for Work and Pensions, December 2003.

**Table 5.1: Levels of support for families from April 2004**

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

**Box 5.1 Child Poverty Review**

The Child Poverty Review was announced in Budget 2003 to feed into policy development for the 2004 Spending Review and beyond. The Child Poverty Review will set out the further welfare reform and public service changes required to halve child poverty by 2010 and to eradicate it by 2020.

During a series of 16 seminars in autumn 2003, the Government consulted extensively with the research community and those delivering front line services in this field, including the voluntary and community sectors, and representatives from primary care trusts, the criminal justice system, local authorities and trade unions. Approximately 220 organisations contributed to the seminar programme, with many organisations also participating in the seminars.

The seminars covered a wide range of issues relating to child poverty: deprived areas; ethnicity; childcare and early years; housing; disabled children; parenting; child crime and anti-social behaviour; education; health outcomes; debt, access to credit and financial inclusion; adult risk factors; transport; employment, particularly of disabled parents; and sharing best practice across the four nations.

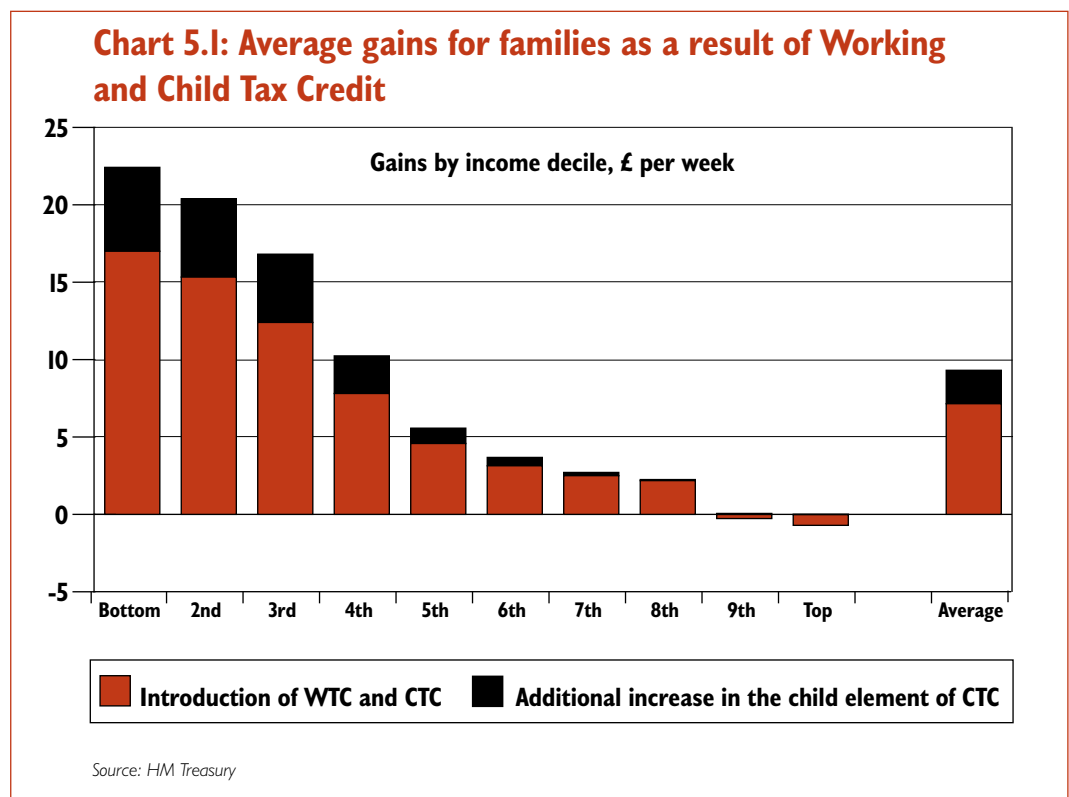
Emerging themes include:

- the importance of providing appropriate, responsive support as children pass through different stages of development;
- the need for additional support for certain groups such as ethnic minority families and families with disabled children;
- the need for policy to work across traditional boundaries; and
- the vital role played by local authorities and the voluntary and community sectors.

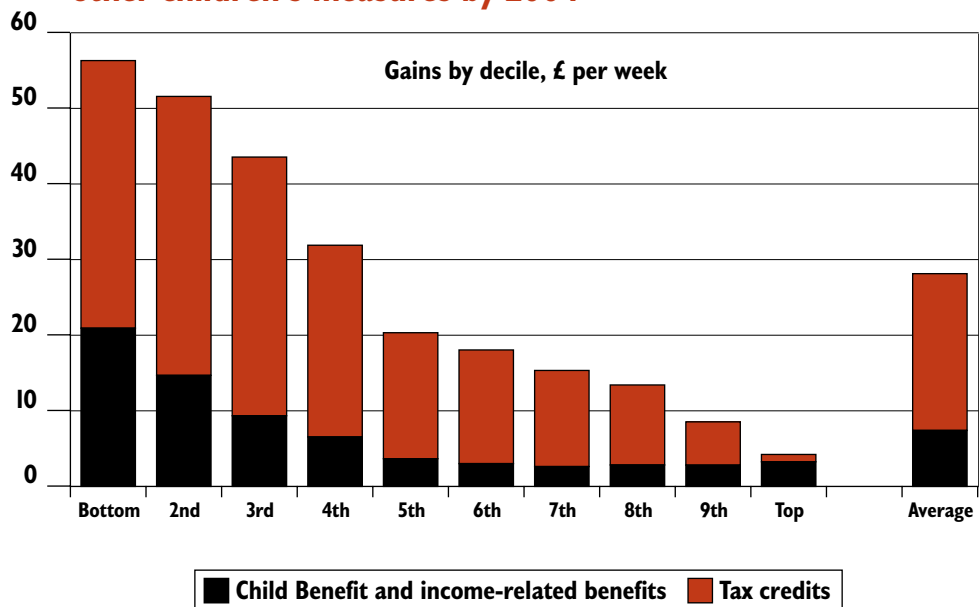
The seminars, written submissions and further research have contributed to an extensive list of suggested policy reforms, which are being considered in the context of the Spending Review. The Child Poverty Review's findings have already influenced the direction of policy. The Government's work to develop a strategy to tackle financial exclusion, referred to later in this chapter, has been developed in conjunction with the Child Poverty Review. Chapter 6 announces new investment plans for the Department for Education and Skills (DfES). The Review has worked with the Childcare Review and the DfES to develop further measures to help achieve equal opportunities for disadvantaged children. Early years and childcare measures are outlined in paragraph 5.24. In addition, more challenging floor targets for schools and a target to narrow the gap in childcare provision between the 20 per cent most disadvantaged wards and other areas will contribute to tackling child poverty.

**5.14** Chart 5.1 shows the average gains for families as a result of the introduction of the Working Tax Credit and the CTC and previously announced upratings, and identifies the additional increase in the CTC as announced in the 2003 Pre-Budget Report. Chart 5.2 shows the impact by income decile of the Government’s reforms to the tax and benefits system, since 1997, on families with children. As a result of reforms since 1997, including measures due to take effect in 2004-05, by October 2004, in real terms:

- families with children will be, on average, £1,350 per year better off, while those in the poorest fifth of the population will be, on average, £3,000 per year better off;
- a single-earner family on half average earnings with two young children will be £3,790 a year better off; and
- a single-earner family on average earnings with two young children will be £285 a year better off.



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



Source: HM Treasury

## Supporting young people

### Review of financial support for 16-19 year olds

**5.15** Building on the success of Education Maintenance Allowances and in response to the Low Pay Commission's (LPC) request to investigate a National Minimum Wage for 16 and 17 year olds, Budget 2003 announced a wider review of financial support for 16 to 19 year olds. The review examined the role of financial support in achieving the Government's skills objectives, alongside supporting families, independent young people and low paid workers. It also examined the case for rationalising the system of financial support for 16 to 19 year olds. The review's report<sup>5</sup> is published alongside this Budget.

**5.16** The review has worked closely with the voluntary and community sectors, consulting young people and parents and gathering evidence from across government, including from the devolved administrations. The aim of the review was to ensure that all young people have the support and incentives they need to participate in education and training.

**5.17** The report sets out the Government's vision that all young people should reach the age of 19 equipped for higher education or skilled employment. Alongside the vision of the Working Group on 14-19 Reform led by Mike Tomlinson for a radically reformed qualification structure culminating in a diploma, the Government has a long-term vision of a single, coherent system of financial support for 16-19 year olds.

**5.18** As an initial step towards this vision, the Government will introduce a package of short-term measures to improve choice, deliver minimum income standards and offer a more individualised, professional service to young people. At the centre of this package is the intention to remove the current distinction in financial support between education and unwaged training and to support young people to finish their courses after their 19th birthday. The Government will consult on these reforms and on its long-term vision for financial support for 16-19 year olds.

<sup>5</sup>Supporting young people to achieve: towards a new deal for skills, HM Treasury, DfES and DWP, March 2004.

**National Minimum Wage for 16 and 17 year olds** **5.19** As outlined in Chapter 4, the Government has accepted the LPC's recommendation that 16 and 17 year old workers should be covered by a new National Minimum Wage of £3.00 per hour from October 2004. The existing exemption from the minimum wage of apprentices aged under 19 will be retained. Employed trainees' wages are currently underpinned by the Minimum Training Allowance (MTA) at £40 a week in England. The MTA was introduced at £35 a week for 17 year olds in 1986, and was raised to £40 a week for 16 and 17 year olds in 1999. In the light of the LPC's recommendations and together with the Learning and Skills Council and employers, the Government would like to achieve minimum pay levels for apprentices in England of £70-£80 a week.

## Supporting parents: balancing work and family life

**5.20** The Government wants to support parents to balance their work and family life, to help them to fulfil their responsibilities to their children and to their employers. By increasing childcare provision and support, working with business to promote the benefits of flexible working and supporting fair working rights, the Government aims to increase choice and support for parents.

**Childcare** **5.21** The Government's vision is for every parent to have access to affordable, flexible, good quality childcare. This is key to achieving a range of Government objectives, supporting child development and removing barriers to parental employment. The Government has therefore invested heavily to support the creation of new childcare places and to extend financial support for childcare costs to more working parents. New childcare places for over 1.6 million children have been created since 1997, reaching the Government's target for 2004, and putting it on course to meet its target of new places for over two million children by 2006.

**5.22** The significant investment in childcare has improved the position for many parents, but the Government recognises that more needs to be done. Budget 2003 announced a Childcare Review to consider whether the long-term projection for childcare and early years education is sufficient to meet the Government's aims; whether the expansion is proceeding quickly enough; and whether there are areas where more remains to be done.

**5.23** The Childcare Review has drawn on a range of expertise from across Government and from key stakeholders in the sector. It has examined a number of issues, including the roll-out of Children's Centres and ensuring effective school-age provision. The Review has worked closely with the Child Poverty Review on the benefits of good quality early childhood education and care for disadvantaged children.

**5.24** The Review's initial findings are reflected in the **Budget allocation for Sure Start, childcare and early years of £669 million additional funding by 2007-08** compared with 2004-05, an average annual real growth rate of 17.3 per cent. This will establish Children's Centres in all of the 20 per cent most disadvantaged wards in England by 2007-08, making Sure Start type services available to the 56 per cent of poor children who live in these disadvantaged areas. **This will mean 1,700 Children's Centres by March 2008**, providing services and linked childcare places, another significant step towards the Government's goal of a Children's Centre for every community. The settlement will also support **100,000 new childcare places, including in extended schools, and a pilot to extend a free part-time early education place to 6,000 two-year olds in disadvantaged areas**. Further details of the settlement for the Department for Education and Skills are set out in Chapter 6.

**Financial support for childcare** **5.25** The Government wants to ensure that childcare is affordable and within reach of all working parents, including those on low and moderate incomes. The childcare element of the Working Tax Credit provides support to working parents for good quality childcare. Following the introduction of new tax credits, help towards childcare costs is now reaching over 300,000 families, up from 180,000 in November 2002, and is worth over £700 million a year.

**5.26** Employers can play an important role in helping employees balance their work and parenting responsibilities. As announced in Pre-Budget Report 2003, the Government is introducing new measures to improve the tax and National Insurance incentives for employer supported childcare, for implementation in April 2005. This introduces **a new tax exemption on up to £50 a week of provision of good quality formal childcare contracted by the employer or paid for with childcare vouchers provided by the employer**. With these new provisions there is no requirement for the employer to have management responsibility for the childcare provision, but where such schemes operate all employees should be able to benefit from them.

**5.27** The Government is keen to extend the range of good quality childcare that is eligible for financial support, through tax credits or the new tax exemption. **Budget 2004 therefore announces a new light-touch voluntary scheme that will enable accreditation for financial support purposes of a broad range of childcare**. This will enable working parents to access financial support. The Government will bring forward proposals for consultation in early summer 2004, for implementation by April 2005. Before that, **from June 2004, parents using breakfast clubs run by schools and those paying for childcare provided by foster carers will be eligible for the childcare element of the Working Tax Credit**.

#### Pay and leave for parents

**5.28** As part of the Government's policy to promote work-life balance, new rights have been introduced for working parents. Mothers now have a right to up to one year's maternity leave and Statutory Maternity Pay was increased to £100 a week for 26 weeks, up from £60.20 a week for 18 weeks in 2000. New fathers and adoptive parents now also have rights for pay and leave and, since April 2003, all parents of children under six have had the right to request flexible working. As announced in the 2003 Pre-Budget Report, **from April 2004, the Government will uprate Statutory Paternity Pay and Statutory Adoption Pay in line with Statutory Maternity Pay, to £102.80 a week from April 2004**.

**5.29** The Government is taking further steps to help parents balance their work and family responsibilities. *Balancing work and family life: enhancing choice and support for parents*<sup>6</sup> set out the Government's strategy in this area and suggested possible reforms. The Government has already implemented some of these steps and is considering a number of options concerning leave for parents.

## FAIRNESS FOR DISABLED PEOPLE

**5.30** The Government is determined to ensure that disabled people have the opportunity to lead independent and fulfilling lives. Chapter 4 sets out the steps the Government is taking to increase employment and financial support for people with a disability who want to work.

**5.31** The Government recognises that families with disabled children often need extra help. From April 2004, the disabled child element of the CTC will be worth over £42 a week on top of the child and family elements of the CTC or the child allowances of Income Support or Jobseeker's Allowance. 106,000 working families were benefiting from the disabled child element of the CTC in January 2004, over three times higher than the number who benefited from disabled child credits in the Working Families' Tax Credit and Disabled Person's Tax Credit.

**5.32** Fairness for disabled people requires an end to discrimination in the workplace and beyond. The Disability Discrimination Act gives disabled people rights in a number of areas. Regulations, which come into force in October 2004, will extend the coverage of the employment provisions of the Act to employers of fewer than 15 employees and to most

<sup>6</sup> *Balancing work and family life: enhancing choice and support for parents*; HM Treasury and Department of Trade and Industry, January 2003.

currently excluded occupations, such as police officers and firefighters. In addition, the Government published a draft Disability Discrimination Bill in December 2003, which will increase opportunities for disabled people and give them a greater say in how services are run.

## FAIRNESS FOR PENSIONERS

**5.33** A fair society guarantees security in old age and ensures that all pensioners can share in rising national prosperity. Building on the foundation of support for retirement income provided by the basic and additional state pensions, the Government launched the Pension Credit in October 2003 to tackle pensioner poverty and reward savings. Tomorrow's pensioners, above this foundation, should be empowered to make their own decisions about their retirement, where possible supported by their employers, and plan their saving and work accordingly. Taking forward the pensions Green Paper, the Government has set out its strategy of informed choice, and is legislating to ensure the success of our voluntarist system, providing people with simplicity, security and choice in working and saving for retirement.

### Security for today's pensioners

**5.34** To ensure that today's pensioners have security in retirement, the Government has introduced a number of measures to improve the incomes of all pensioners. It has:

- increased the basic state pension by more than the level of inflation in each of the last three years. **In April 2004, the full basic state pension will increase further to £79.60 a week for single pensioners and to £127.25 a week for pensioner couples**, annual increases of more than £100 for single pensioners and nearly £180 for couples;
- guaranteed that the basic state pension will continue to rise each April by 2.5 per cent or the increase in the Retail Prices Index for the previous September, whichever is higher; and
- launched the Pension Credit in October 2003 to guarantee a minimum income and reward those with modest savings or other income.

**5.35** In addition the Government has introduced a range of measures to help pensioners offset certain costs of living. These include:

- winter fuel payments worth £200 per household each year for the remainder of this Parliament, benefiting around 11 million people aged 60 or over. This was increased to £300 for households with someone aged 80 or over from winter 2003-04;
- free TV licences for households with someone aged 75 or over and free eye-tests and prescriptions for all those aged over 60; and
- abolished hospital downrating for stays up to 52 weeks, and introduced concessionary travel for those aged over 60.

**Council tax payment for pensioners over 70** **5.36** The Government understands the position of older people on fixed incomes facing pressures such as higher council tax bills and thus a reduction in their standard of living. Council tax consumes a greater proportion of the incomes of older pensioners – who have little or no opportunity to increase their incomes – than it does for other households. Alongside Council Tax Benefit **the Government believes that it is right to help older pensioner households with their council tax. Pensioner households with someone aged over 70 will therefore receive a £100 payment to help with their council tax bills.** Allowing also for the Winter Fuel Payment, households with someone aged 70 or over will this year receive at least £300. Households with someone aged 80 or over will benefit in total by £400.

**Pension Credit 5.37** To tackle pensioner poverty and reward saving for retirement, the Government built on the Minimum Income Guarantee by introducing the Pension Credit in October 2003. From April 2004, the Pension Credit will guarantee an income of at least £105.45 a week for a single pensioner and £160.95 for pensioner couples. The guarantee element of the Pension Credit will be linked to earnings throughout this Parliament. Over 2.7 million pensioners now receive the Pension Credit.

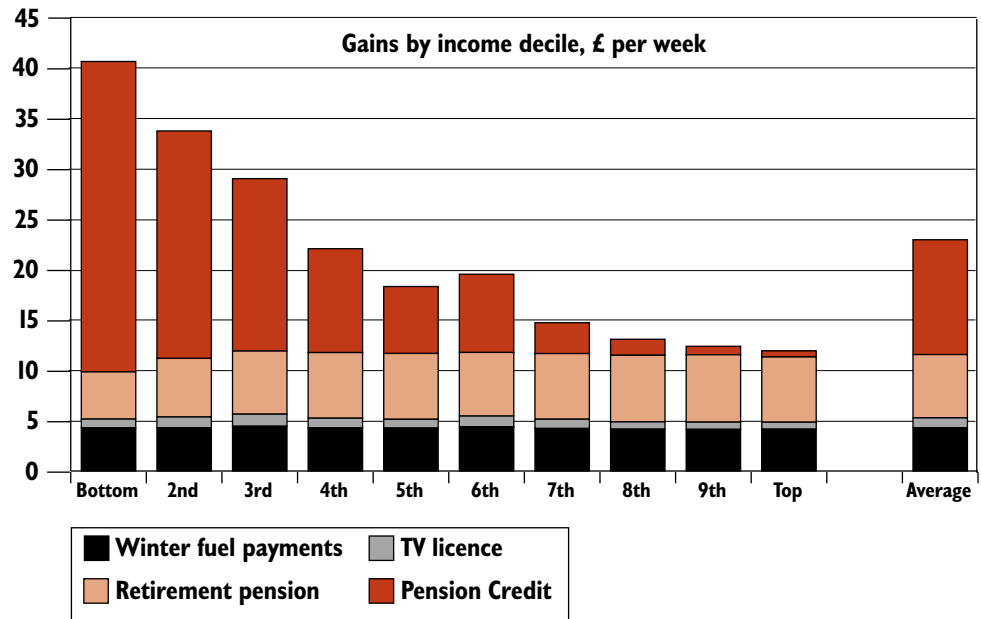
**5.38** Around half of all pensioner households stand to gain an additional £400 a year on average under the Pension Credit. As a result of the Pension Credit, the poorest third of pensioners will be around £600 a year better off on average than if the equivalent amount had been spent on raising the basic state pension. All eligible applications received before October 2004 will be backdated to the start of the Pension Credit in October 2003 or to the date of the entitlement if that is later. **Budget 2004 announces that for applications received after October 2004, the maximum period of backdating allowed will be extended from three months to 12 months.** To encourage and help people to claim their entitlements, the Pension Service is promoting a range of **measures to encourage claims and increase take up including a trial of targeted entitlement checks in one region during the summer for groups including the over 80s.**

**Effects of measures to support pensioners 5.39** From 2004-05, as a result of measures introduced since 1997, including the Pension Credit, the Government will be spending around £10 billion more in real terms on pensioners. This is £6 billion more than the cost of indexing the basic state pension to earnings since 1998. Chart 5.3 shows the distributional impact, in current prices, of the Government's measures to support pensioners introduced before April 2004. As a result of personal tax and benefit measures introduced since 1997, in 2004-05:

- pensioner households will be, on average £1,350 a year better off in real terms, or around £26 extra a week; and
- the poorest third of pensioner households will be on average £1,750 a year better off in real terms.

**Support for pensioners who pay tax 5.40** Almost half of pensioners pay no income tax, but for those who do, the **age-related personal allowances in 2004-05 will rise in line with earnings to £6,830 for people aged between 65 and 74 and to £6,950 for those aged 75 or over.** No pensioner aged 65 or over will pay tax on income of less than £131 a week in 2004-05. The age-related personal allowances will continue to rise at least in line with earnings rather than prices for the remainder of this Parliament.

**Chart 5.3: Overall gains for pensioner families from pensioner policies**



Source: Department for Work and Pensions.

## Supporting tomorrow's pensioners

### Taking forward the Pensions Green Paper

**5.41** The December 2002 Green Paper<sup>7</sup> on pension reform set out the challenges in helping to ensure future pensioners are able to build up retirement incomes that meet their expectations. Following an extensive consultation, the measures in the Green Paper have been developed and taken forward through legislation, the publication of *Informed choices for working and saving*,<sup>8</sup> combatting age discrimination and promoting extended working lives. This radical programme of action is designed to ensure:

- *simplicity* – in addition to introducing a new simplified taxation regime for pensions, the Government is replacing the Minimum Funding Requirement with Scheme Specific Funding arrangements to give schemes greater flexibility over their funding strategy, simplifying contracting out arrangements, and ensuring people have access to simple and flexible savings products;
- *security* – under the Pensions Bill, a new pro-active regulator will be introduced to protect the interests of members of work-based pension schemes. The Pension Protection Fund will protect members of private sector defined-benefit schemes whose sponsoring employer becomes insolvent at a point in time when the scheme is under-funded; and
- *choice* – the Government is helping people make informed choices about their retirement, and removing barriers to working longer.

<sup>7</sup>*Simplicity, security and choice: Working and saving for retirement*, Department for Work and Pensions, HM Treasury and Inland Revenue, December 2002.

<sup>8</sup>*Simplicity, security and choice: Informed choices for working and saving*, Department for Work and Pensions, February 2004.

**Pensions tax simplification 5.42** The Government provides generous tax relief to encourage people to save for their retirement. Private pensions are the most tax-favoured form of saving, receiving tax incentives worth £21 billion a year (£13 billion net after income tax paid by pensioners). National Insurance relief on employer contributions is worth a further £5 billion. However, the existing eight taxation regimes have complex rules that limit annual contributions to, and final benefits from, a pension scheme. This imposes unnecessary inflexibility and complication, drives up costs and discourages people from saving in a pension.

**5.43** *Simplifying the taxation of pensions: the Government's proposals*,<sup>9</sup> published alongside the 2003 Pre-Budget Report, set out proposals to simplify radically the taxation of pensions, replacing the eight current regimes with a single lifetime allowance on the amount of pension savings that can benefit from tax relief. In the 2003 Pre-Budget Report, in response to concerns expressed during consultation, the Government asked the National Audit Office to consider:

- whether it is factually accurate that the £1.4 million lifetime allowance is, using a factor of 20:1 to calculate the capital value of a defined benefit pension, equivalent to the maximum pension available under the current occupational pensions regime which includes the earnings cap;
- whether it is reasonable for the Government to estimate that around 5,000 people will have pension funds in excess of £1.4 million at 5 April 2005; and
- whether it is reasonable for the Government to estimate that around 1,000 people a year may be affected by the lifetime allowance who would not have been affected by the earnings cap.

**5.44** The National Audit Office reported before the Budget.<sup>10</sup> Its conclusions were:

- £1.4 million is broadly equivalent to the maximum pension allowable under the current occupational pensions regime, which includes the earnings cap;
- the estimate of 5,000 people is at the lower end of a range of reasonable estimates. Sensitivity testing and other evidence is consistent with an estimate of around 10,000. Other estimates of the numbers affected – up to 600,000 have been quoted – include large numbers of people already capped by the existing earnings cap, and so are not directly comparable; and
- there is no evidence to discredit the estimate of around 1,000 people a year for the next ten years.

**5.45** The Government welcomes the report. The few thousand people with pension funds in excess of £1.4 million contrasts with the many millions of people who will gain from greater simplicity and flexibility. The response from the second consultation has been overwhelmingly positive, with almost all respondents favouring the new regime. **The Government is therefore proceeding with the proposals set out in the December 2003 document**, replacing the eight current regimes with a single lifetime allowance on the amount of tax-privileged pension saving. In response to concerns expressed in the consultation, the Government will:

- **legislate in Finance Bill 2004 to implement the simplified regime in April 2006**, allowing employers and providers sufficient time to fully implement the benefits of simplification;

<sup>9</sup>*Simplifying the taxation of pensions: the Government's proposals*, HM Treasury and Inland Revenue, December 2003.

<sup>10</sup>*The Government's estimates of the impact of the pensions lifetime allowance*, National Audit Office, 9 March 2004.

- **set the lifetime allowance on introduction at £1.5 million** to reflect an April 2006 implementation date;
- to provide certainty, **pre-announce the lifetime allowance for all years up to 2010 such that it increases steadily to £1.8 million in 2010;**<sup>11</sup> and
- **review the lifetime allowance level and indexation every 5 years**, with the first review in 2010.

Other responses to the consultation document are still being considered and may lead to minor changes, which will be announced in due course.

**5.46** The simplified system will help people make informed choices about working and saving for retirement, by:

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

**5.47** Under the current system, lump sum payments are currently made by many occupational pension schemes to the spouses of pension scheme members who die within five years of retirement. Under the simplified pensions regime, subject to the lifetime allowance, these lump sum payments will continue to be able to be made tax free, with the potential for many scheme providers to offer larger tax-free lump sum payments. Under the simplified regime, where a member dies before age 75, it will be possible for the scheme provider to arrange for a capital sum equal to any unused lifetime allowance to be paid tax-free along with unlimited dependants' pensions, instead of the current specific provision to allow schemes to pay a tax-free lump sum equal to the balance of five years' payments undrawn at the time of the member's death.

**Informed choices for working and saving** **5.48** Empowering individuals to make informed choices about working and saving for retirement is fundamental to ensuring that future pensioners receive the income in retirement that they expect. *Informed choices for working and saving* sets out the Government's strategy, which is based on activation, education and information, and includes:

- issuing 1.6 million state pension forecasts to the self-employed by the end of 2003-04, and sending out 8 million automatic state pension forecasts in 2005-06;
- ensuring 6.3 million people receive combined pension forecasts. The 2004 Pensions Bill provides the Government with reserve powers to compel employers to provide these forecasts, should evidence show that they could make a significant difference to savings levels;

<sup>11</sup>The lifetime allowance will be: £1.50 million in 2006; £1.60 million in 2007; £1.65 million in 2008; £1.75 million in 2009; and £1.80 million in 2010. Similarly, the annual allowance will be: £215,000 in 2006; £225,000 in 2007; £235,000 in 2008; £245,000 in 2009; £255,000 in 2010.

- developing an on-line retirement planner so that people can see the impact of varying their savings levels or working longer than they currently plan to;
- acting to ensure that people have the tools to understand this information. The introduction of the Sandler suite of products and reforms to improve employment opportunities for older workers will mean that people have genuine choices available when it comes to working and saving; and
- making information and guidance available to employers to draw attention to the benefits to themselves and to the wider economy of employing older workers. Chapter 4 sets out other measures the Government is taking to extend employment opportunity to older workers.

**5.49** To support employers who help their employees through these decisions, **the Government will exempt pensions information and advice from being a taxable benefit, subject to it being generally available to all employees and below a limit of £150 for each employee per year.**

#### **Deferring the state pension**

**5.50** The employment rate of people aged between 50 years and state pension age has risen from 65 per cent in 1997 to 70 per cent now. Of those at or over state pension age, 9.2 per cent are in employment now compared with 7.7 per cent in 1997. The Government is providing people who wish to work longer more choice and flexibility to do so, by introducing, through the Pensions Bill, the option of taking a deferred state pension as a taxable lump sum instead of higher weekly pension payments.

**5.51** Those choosing to defer their state pension for at least one year from April 2005 will be able to take a lump sum. **Interest will be payable on the deferred pension for those choosing the lump sum at Bank of England base rate plus 2 per cent.** The Government believes that this is a fair rate which rewards those who choose to defer their state pension. The lump sum will be taxed at the recipient's marginal rate on his or her other income to ensure that pensioners do not move into a higher tax bracket as a result of taking a lump sum. It will not affect pensioners' age-related income allowances, and **people who defer their state retirement pension and who may be eligible for Working and Child Tax Credits, Housing Benefit or Council Tax Benefit will have their notional state retirement pension disregarded for the purpose of assessing their entitlement while deferring.**

**5.52** Alternatively, for people who defer and choose state pension increments from April 2005, their pensions will rise by 10.4 per cent a year instead of the current rate of just under 7.5 per cent a year. A person deferring a state pension of around £100 a week for five years could see their pension rise to around £152 a week – an increase of around £14.75 a week compared with the current system.

**Pension statistics 5.53** Pension statistics are an important issue: the Pension Statistics Review Committee, comprising academics, industry experts and officials from various Government departments, is overseeing progress on implementing the pensions review action plan<sup>12</sup> which aims to improve the quality and range of data available on pensions. The most recent progress report<sup>13</sup> highlights changes which will lead to improved data flows during the next 12 to 15 months. The Committee is also developing priorities for further work on pensions statistics over the longer term.

**5.54** In addition, the new Pensions Regulator, being introduced as part of the Pensions Bill, will collect data to support its own risk-based work and the work of the Pension Protection Fund. This will include information about the levels of funding of defined-benefit occupational pension schemes. The Pensions Regulator is likely to collect data from April 2005.

## PROMOTING SAVING AND ASSET OWNERSHIP

**5.55** The Government's strategy for promoting saving and asset accumulation is founded on its principles of opportunity, responsibility and security, which underpin the welfare state:

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

**The Child Trust Fund 5.56** The Government is committed to strengthening the saving habit of future generations and ensuring that all children have a stake in the wealth of the nation. The Child Trust Fund (CTF) will provide an endowment for every child at birth and at age seven, with those from the poorest families receiving the largest amounts, and will be underpinned by increased financial information and education for parents and children. The Government published its detailed proposals<sup>14</sup> for the CTF in October 2003 and draft regulations<sup>15</sup> in February 2004. The draft regulations announced that:

- charges for stakeholder CTF accounts will be capped at 1.5 per cent per year and that providers must accept contributions of £10 and above;
- no charges will apply to transfers between different types of accounts, including from stakeholder to non-stakeholder, and between providers; and
- the stakeholder CTF account must be diversified and lifestyled.

**5.57** The Government's decision to set the charge cap at 1.5 per cent for the stakeholder CTF was based upon all available evidence, and it recognised that the CTF had certain key characteristics which were not typical of other products in the stakeholder suite, including stakeholder pensions. The 1.5 per cent cap is in the best interests of consumers, as it encourages as wide a selection of providers as possible to offer CTF accounts. A large number of providers will encourage competition and ensure the best value for consumers. The Government will continue to monitor the level of the charge cap to ensure it best meets the interests of consumers.

<sup>12</sup> *Review of Pension Contributions Statistics*, Office of National Statistics, September 2002.

<sup>13</sup> *Pension Statistics Review Progress Report*, Office of National Statistics, December 2003. Available at: [www.statistics.gov.uk](http://www.statistics.gov.uk).

<sup>14</sup> *Detailed proposals for the Child Trust Fund*, HM Treasury and Inland Revenue, October 2003.

<sup>15</sup> *The draft Child Trust Fund regulations 2004*, February 2004. Available at [www.ir.gov.uk](http://www.ir.gov.uk)

**The Saving Gateway 5.58** The Saving Gateway is designed to be an ideal starting point for many low-income individuals who would otherwise have difficulty starting on the savings ladder. The aim of the Saving Gateway is to encourage saving by means of a Government-funded match of all money saved, up to a limit. The most recent evaluation of the Saving Gateway pilots is available on the HM Treasury website.<sup>16</sup> The indications are positive and the Government looks forward to further evaluation.

**Individual Savings Accounts 5.59** Individual Savings Accounts (ISAs) are the Government's primary vehicle for tax-free saving outside pensions. Over 15 million people now have an ISA and over £130 billion has been subscribed to ISAs since their launch in 1999.

**The Sandler review of retail savings 5.60** In July 2002, the Sandler review<sup>17</sup> made a series of recommendations, including the design of a simple product suite that could be marketed outside the Financial Services Authority's (FSA) Conduct of Business regulations. In response, the Government has been developing a suite of simple, low-cost, risk-controlled products. The stakeholder suite will be on the market from April 2005. HM Treasury has been working closely with the FSA in developing these products, and the Government is keen to take forward work on the sales regime and the product design together. The FSA aims to have completed its research by the end of May 2004. Once the FSA has reached a satisfactory conclusion, the Government will announce the charge cap for stakeholder products and consult on the regulations. It will also publish independent research undertaken by Deloitte on the effects on the stakeholder market of different charge structures.

**5.61** In addition, the Government continues to examine the scope for simplifying and modernising the taxation of pooled investment schemes. This is a complex area and discussions with the industry representative bodies are taking place before any next steps are announced. The consultation on property investment funds, described in Chapter 3, will also provide an opportunity to discuss wider issues.

**Treatment of capital limits 5.62** The Government will keep under review the treatment of capital in income-related working-age benefits. As a first step, **from April 2006, the threshold above which savings reduce eligibility for Income Support, Jobseeker's Allowance, Housing Benefit and Council Tax Benefit will be raised from £3,000 to £6,000.**

**Promoting financial inclusion 5.63** Through the Child Trust Fund and the Saving Gateway pilots, the Government is exploring policies to encourage saving and asset-building. However, for many low income households the urgent need is access to affordable banking services and credit. In 1999, the Government published the Social Exclusion Unit's Policy Action Team report *Access to Financial Services*.<sup>18</sup> Most of the key recommendations are now in place but significant progress remains to be achieved in three key areas:

- access to banking services – around 3 million households in Great Britain<sup>19</sup> do not have a current account and therefore face higher costs in paying bills. Around 1.5 million households have no mainstream financial products at all. Despite the introduction of the Basic Bank Account in 1999 the number of households operating outside the financial mainstream – facing higher costs to cash cheques as well as pay bills - has not fallen significantly;
- access to affordable credit – problem debt hits low income families hardest – households with an income of less than £7,500 make up 57 per cent of all over-

<sup>16</sup> *Evaluation of the CFLI and Saving Gateway Pilots*, December 2003. Available at [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

<sup>17</sup> *Medium and Long-Term Retail Savings in the UK: A Review*, Ron Sandler, HM Treasury, July 2002.

<sup>18</sup> *Access to Financial Services*, Report of PAT14, HM Treasury, November 1999.

<sup>19</sup> *Family Resources Survey 2001-02*, Department for Work and Pensions, May 2003.

indebted households (where debt repayments are over 25 per cent of household income).<sup>20</sup> This group is most likely to use the 'alternative credit market', including sale and buyback shops, pay day loans and doorstep lenders. While some consumers value the convenience of these services, vulnerable consumers without alternatives must pay interest rates many times those of a standard overdraft; and

- access to free debt advice – the FSA has found that 6.1 million families reported some difficulties meeting their debt repayments<sup>21</sup> and Citizens Advice Bureaux have reported a substantial increase in new debt enquiries and are now dealing with well over a million new debt enquiries per year, two-thirds of which are related to consumer credit debts.

**5.64** The Consumer Credit White Paper<sup>22</sup> contains proposals to improve transparency and fairness of credit markets and a strategy to tackle over-indebtedness. The problem of financial exclusion exacerbates the debt problems of the most vulnerable. Government will work in partnership both with the financial services sector and with voluntary and community bodies to achieve:

- dramatic reductions in the 3 million households without a current account and the 1.5 million households without an account of any kind;
- a significant increase in the availability of affordable credit for those on the lowest incomes; and
- a step change in the availability of free debt advice for those who need it.

**5.65** The Government will work with the financial services industry to bring forward specific proposals in the summer.

**The Social Fund 5.66** The Social Fund provides a safety net of grants and interest free loans for the most vulnerable in times of crisis. Budget 2003 announced an additional £90 million for the Discretionary Social Fund over the three years to 2005-06. The Government has also implemented some administrative changes to improve monitoring and ensure existing resources are being directed to those most in need.

## SUPPORTING COMMUNITIES, CHARITIES AND GIVING

**5.67** The Government believes that a thriving and active sense of citizenship – strengthened by an independent voluntary and community sector and a culture of volunteering and giving – is vital for fair and enterprising communities. The Government's support for the sector has been demonstrated by the wide range of tax and spending measures introduced since 1997, described in detail in Table 5.2 in the 2003 Pre-Budget Report.

**Giving 5.68** The Giving Campaign, set up in 2001 as a three-year promotion to encourage payroll giving has been very successful. The Campaign will come to an end in 2004, but it has been a key catalyst in increasing the value of amounts donated from £37 million in 1999-2000 to £86 million in 2002-03. This success was supported by the removal of the cap on donations and the 10 per cent Payroll Giving Supplement, which was introduced in April 2000 initially for three years and extended in 2003 for a further and final year. A continuing legacy of the Giving Campaign is the successful Giving Nation, developed to fit National Curriculum activity in citizenship, and encourage more young people to give their time and money to help others.

<sup>20</sup> Over-indebtedness in Britain: a report to the Department of Trade and Industry, Elaine Kempson, 2002.

<sup>21</sup> Financial Risk Outlook, FSA, 2004.

<sup>22</sup> *Fair, clear and competitive: the consumer credit market in the 21st century*, Department of Trade and Industry, December 2003.

**5.69** The Government remains committed to encouraging payroll giving and, in particular, wants to see more employers setting up schemes. To this end, **the Government is launching a Payroll Giving Grant for SMEs who agree to offer their staff the opportunity to give through the payroll.** Proposals for the scheme will be announced shortly. The Government will also work with the business community to provide a guide to tax incentives for corporate giving to charity, and explore the potential for an intensive data collection exercise on corporate giving.

**Volunteering and mentoring**

**5.70** Giving time is as important as giving money. There is wide agreement that volunteering has benefits for the services volunteers work within, the volunteers themselves and our communities in building social cohesion. The Government is keen to promote measures that will help and encourage more people to volunteer, especially the young. The Government is therefore **establishing a Commission headed by Ian Russell of ScottishPower to report to the Government by the end of the year on the way forward for a National Youth Volunteering Strategy, building on existing expertise and experience.** In recognition of the Pre-Budget Report commitment, the Commission will be asked to consider how sport volunteering and mentoring opportunities can be more inclusive as part of a national call to service. The Commission will involve a wide range of stakeholders including VCS organisations who lead on working with young people, business and young people themselves in the consultation process. The Government realises the role mentoring can have in society and, building on existing initiatives is committed to developing a national and local infrastructure that offers mentoring opportunities in every area of the country.

**CEF and Sport Relief**

**5.71** The Chancellor launched the Commonwealth Education Fund (CEF) in 2002 to mark the Queen's Golden Jubilee year. The CEF works in developing Commonwealth countries to support progress towards the education Millennium Development Goals, helping civil society to work strategically with governments to take forward national education plans. The Government provided an initial £10 million to the CEF and **will continue to match, for a further year until April 2005, any CEF donations raised, pound for pound up to £10 million. It will also provide money to Comic Relief's Sport Relief in July 2004 by matching pound for pound, up to £5 million, donations raised for that appeal to go towards education in developing Commonwealth countries.** Matched tax relief is included in both cases.

**Unclaimed assets**

**5.72** The Government supports the efforts of the British Bankers' Association, the Building Societies' Association and National Savings & Investments in trying to reunite unclaimed assets and their owners. It is right in principle that more should be done. Where assets and owners cannot be reunited, it is also right that the assets be reinvested in society, as long as the original owners' entitlements to reclaim are preserved. Charitable and voluntary organisations would provide an effective route for this.

**5.73** The Government welcomes the creation of the Balance Charitable Foundation for unclaimed assets, and the commitment made by two major investment banks to pass over some of their unclaimed assets to the Foundation. The proceeds of such transfers should be distributed fairly across the charitable and voluntary sector. Distributing organisations for these monies should be run in an open and consultative manner, in accordance with best governance practice and with the involvement of the financial services industry and the voluntary and community sectors.

**5.74** The Government looks to the industry to build on current momentum, and expand the scope of voluntary action beyond investment banking into retail banking and the wider financial sector. The Government will assess and report on progress at the time of the 2004 Pre-Budget Report.

**Museums and VAT** **5.75** Every member of society has a right to access the UK's cultural heritage, made possible by public support for museums and galleries. The Government's commitment to achieve free access to the main national museums and galleries has proved an outstanding success, with visitor numbers up 70 per cent since the policy was introduced. Building on that success, and on the recommendation of the Goodison review,<sup>23</sup> **the Government will consider the issue of extending the free access commitment for the main national museums and galleries, and the VAT refund scheme that has helped to deliver it, to university museums in the context of the forthcoming Spending Review.**

**Listed places of worship** **5.76** The Government has been negotiating with its European partners on a review of the EU rules governing VAT reduced rates. It remains one of the Government's clear objectives to achieve a permanent reduced rate of VAT for repairs to listed places of worship, which would offer the permanence, simplicity and certainty that a grant scheme cannot. However, against a background of success, with around 4,500 listed places of worship having benefited from congregations spending over £140 million since 2001, the Government is keen to promote even greater take-up of the scheme to help tackle any backlog of repairs and promote the upkeep of Britain's historic places of worship. Therefore, for spending from 1 April 2004 until March 2006, unless a permanent VAT reduced rate is achieved earlier, **grants will be paid to cover all the VAT on the repair and maintenance of listed places of worship.**

**Gift aid day memberships** **5.77** The Government announced in the Pre-Budget Report that it would consult charities on an amendment to the special exemption in the Gift Aid rules which allows certain heritage and conservation charities to offer free admission in return for a donation which attracts Gift Aid. Gift Aid is designed to promote giving to charity by individuals but, by simply reclassifying admission fees as donations on which Gift Aid is then claimed, these schemes do not generate additional giving. The Government has received a number of representations from the charitable sector in response and recognises the concerns expressed. It will continue this consultation to determine a way forward that preserves the principles and intentions of Gift Aid while dealing sympathetically with the charities affected by the proposed change. It will work closely with the heritage and conservation sector to complete the consultation on developing a new definition of the special exemption. It aims to announce the results of the consultation around the time of the Spending Review giving charities the opportunity to take account of the changes in their financial planning, alongside the wider Government support for this sector which is now worth over £2 billion a year.

**Football Supporters' Trusts** **5.78** Under the review into the Inland Revenue treatment of Supporters' Trusts announced in the 2003 Pre-Budget Report, the Government is currently examining how best to assist Football Supporters' Trusts in their valuable work in local communities, by maximising the benefit they receive from the contributions of their members.

<sup>23</sup> Goodison Review: *Securing the best for our Museums : Private Giving and Government Support*, HM Treasury, January 2004.

## DELIVERING A MODERN AND FAIR TAX SYSTEM

**5.79** A modern and fair tax system encourages work and saving, keeps pace with developments in business practice and the global economy and raises sufficient revenue to fund the Government's objective to build world-class public services.

**Revenue Departments Review** **5.80** The Government today publishes the report of the Review of Revenue Departments,<sup>24</sup> led by Gus O'Donnell, the Permanent Secretary to the Treasury, and accepts its recommendations. The most important recommendation is that **a new single department should be established, integrating HM Customs and Excise and the Inland Revenue**. The creation of a single, customer-focused, department, which makes better use of the information that taxpayers provide, will improve tax collection from the non-compliant and reduce costs for the compliant, helping to improve the fairness of the tax system.

### Protecting tax revenues

**5.81** A tax system in which everyone pays or claims what is due forms the basis for the Government's objectives of stable public finances and world-class public services. Tax avoidance and evasion undermine these objectives, and also damage the integrity of the tax system, by undermining incentives and by shifting a greater burden of tax onto honest and compliant taxpayers. The Government is therefore determined to close down opportunities for avoidance and evasion.

**New compliance package** **5.82** To this end, the Inland Revenue will receive additional resources to support a new compliance and enforcement package for direct taxes and National Insurance contributions. The funding will provide for:

- additional resources, including specialist staff, to address tax at risk among large companies and those taxpayers who have complex tax affairs;
- better use of taxpayer information and additional staff to improve the focus of compliance activity; and
- greater use of publicity to support and encourage those currently outside the tax system to meet their tax obligations.

**5.83** The package is expected to produce an additional £2 billion in revenue over the next three years. However, in line with the Government's cautious approach to the public finances, a lower figure of £1.7 billion has been audited by the NAO and is included in the public finances forecast.

**Tackling tax avoidance** **5.84** Schemes designed to avoid tax represent a significant threat to the integrity of the tax system. These sophisticated and aggressive avoidance schemes thrive on concealment and secrecy. Therefore, Budget 2004 introduces new measures to improve transparency in the tax system. The rules, aimed at those marketing and using certain tax avoidance schemes and arrangements, will allow early detection of such schemes and enable more effective targetting of avoiders. As a result of these measures:

- **promoters who market schemes and arrangements that meet certain criteria for direct taxes will be required to disclose details of these schemes to the Inland Revenue;** and
- **businesses with an annual turnover of £600,000 or more using VAT avoidance schemes that appear on a statutory list, and businesses with an annual turnover of £10 million or more using VAT arrangements that meet certain criteria, will be required to notify HM Customs and Excise.**

<sup>24</sup> *Financing Britain's future*, Review of the Revenue Departments, HM Treasury, March 2004.

**5.85** In addition, the Government is taking action to close a number of loopholes currently being exploited to avoid tax, including:

- preventing company profits being wrapped up in a partnership structure and extracted as untaxed or low-taxed capital receipts;
- stopping two avoidance schemes where users obtain a double relief for the cost of capital assets used in their business;
- countering avoidance by life companies using financial reinsurance; and
- further measures to prevent exploitation of loopholes in the VAT system.

**5.86** These and other measures are set out in more detail in Chapter A.

**Modernising the  
tax system for  
trusts**

**5.87** Trusts have a positive role to play in helping people to manage their affairs, but the Government is determined that they should not be used to achieve unfair tax avoidance. The 2003 Pre-Budget Report therefore announced a series of measures designed to tackle complex tax avoidance schemes using trusts, and made clear the Government's intention to protect the most vulnerable.

**5.88** The Government has been clear since the outset of consultation that the income tax charge on pre-owned assets, which takes effect from April 2005, would not affect legitimate transactions between family members. The Government therefore confirms that the charge:

- will not affect parents or grandparents who have helped their children or grandchildren onto the property ladder;
- will not affect transactions between married couples;
- will not apply where the benefit is incidental;
- will not apply if the assets still count as part of the taxpayer's estate for inheritance tax purposes;
- will not apply if a person who has used a contrived avoidance scheme to remove their property from the inheritance tax system opts to bring the property back into their estate for inheritance tax purposes; and
- is not retrospective as it will not take effect until April 2005.

**5.89** The Government has also consulted on ways to make the system of trust taxation less burdensome for those not using trusts for tax avoidance purposes. The Government has today announced that it will:

- bring in new rules so that trusts set up for the most vulnerable are taxed as if the vulnerable person was receiving the income and gains directly, therefore ensuring that they enjoy the full benefit of their personal allowances and lower rate bands; and that
- introduce a basic rate band for trusts, which means that around 30,000 trusts that receive small amounts of taxed income will have no further liability and will no longer have to submit a self assessment return every year.

**5.90** The Government will continue to discuss modernisation with the trust sector and will publish draft legislation alongside the 2004 Pre-Budget Report.

**Small business tax incentives** **5.91** The Government has introduced a range of tax measures to support small businesses, including reductions in both income tax and corporation tax, payable tax credits for research and development, and cuts in capital gains tax which mean the UK now has the most favourable regime for business capital gains amongst all major developed economies. Chapter 3 sets out further measures to support small firms, and to encourage them to innovate, invest and grow. This includes, in response to requests from a number of industry representative bodies, an **extension of first year capital allowances for small firms investing in plant and machinery to 50 per cent from 1 April 2004 for one year**, after which the measure will be reviewed.

**5.92** As part of this strategy, the Government believes that transition to the corporate legal form can be an important step in the development of a business, and can assist small businesses in realising their growth potential by providing flexibility in access to external finance, improving governance and managing risk. The Government is committed to ensuring that the UK remains one of the easiest places to start and grow a business. As set out in the 2003 Pre-Budget Report, the Government is determined to ensure that the measures it has introduced provide support for firms taking on the opportunities and responsibilities involved in that transition, by encouraging them to reinvest their profits and grow their business.

**5.93** The Government is therefore concerned about the increasing numbers of self-employed individuals adopting the corporate legal form where the change is made for tax reasons rather than as a step to growth, often as a result of marketed tax-avoidance schemes. Following the announcement in the 2003 Pre-Budget Report, the Government has reviewed options for more closely aligning the tax paid by these individuals with their economic characteristics. Having considered a range of options, the Government is determined to proceed in a way that protects the benefits of low tax rates for those investing in their businesses. **With effect from 1 April 2004, the Government will therefore introduce a 19 per cent minimum rate of corporation tax on distributed profits.** This measure will ensure that corporate tax rates lower than 19 per cent, including the zero rate of corporation tax introduced in April 2002, remain available to small companies as they re-invest in their business. Businesses re-investing their profits, or companies with taxable profits above £50,000, will be unaffected by this measure.

**5.94** The Government will also take steps to reinforce compliance with the tax system by the smallest companies, while preventing compliant businesses from facing additional burdens. The Government will introduce two specific measures to address the compliance risks associated with those incorporating for tax reasons:

- **the Government will bring forward legislation in Finance Bill 2004 to ensure disclosure of basic tax information on incorporation**, by making the existing registration form for corporation tax compulsory; and
- **the Government will consider measures to strengthen anti-avoidance legislation on loans made to shareholder directors of close companies**, reinforcing existing legal obligations under Company Law.

**5.95** The Government is determined to continue with a forward programme of targeted tax incentives, in support of its objectives for growth, enterprise and productivity. In some areas, the pursuit of these objectives through the tax system may be constrained by the ability to match definitions for tax purposes with underlying economic characteristics. The reform of the Construction Industry Scheme is an example where Government and the industry are discussing how to address these definitional issues as they relate to construction; in this case the dividing line between employment and self-employment earnings. Across many other

sectors, the growth in small owner-managed businesses, as well as the changing nature of employment and contractual relationships, is creating challenges for the definitions and boundaries in the tax and national insurance systems between income from self-employment and the remuneration of owner-managers. The Government therefore proposes to consider the strategic issues raised by these developments, to ensure that the tax system reflects the realities of today's changing labour market and business environment. A discussion paper will be issued at the time of the 2004 Pre-Budget Report.

**Alcohol fraud 5.96** The 2003 Pre-Budget Report set out proposals for an enhanced strategy to tackle alcohol fraud, against a backdrop of:

- success in taking tough action to tackle fraud across the other indirect tax regimes, with the previous trend of growing fraud now decisively reversed in the tobacco and oils regimes and indications of a sharp fall in levels of VAT missing trader fraud;
- success in reducing cross-channel passenger smuggling of alcohol, which fell by 90 per cent between 2000 and 2002; and
- estimates showing a significant and rising level of revenue losses through spirits fraud, costing £600 million in lost duty and VAT in 2001-02, despite the action taken by HM Customs and Excise and the alcohol industry.

**5.97** As part of that strategy, the Government proposed to implement the Roques report recommendation to introduce tax stamps for spirits, in order to enable consumers, traders and Customs to distinguish fraudulent from duty-paid product and to reduce both the opportunities for and profitability of spirits diversion fraud. Recognising the potential impact on the legitimate trade, the Government also said that it would consider any alternative proposals the spirits industry put forward that would be as effective in tackling fraud as tax stamps, and that, if it had to proceed with tax stamps, it would consider measures to help offset and mitigate the compliance costs to the legitimate trade. The 2003 Pre-Budget Report also confirmed the introduction of new regulatory controls to support the fight against alcohol fraud, following consultation last summer.

**5.98** Since the 2003 Pre-Budget Report, the Government and the industry have worked together closely and intensively to take forward the development of the alcohol strategy. The National Audit Office has examined the range of fraud estimates made by both Customs and the industry. The Government welcomes the constructive approach that has been taken by the trade, and the recognition by all parties that action must be taken to tackle fraud. The Government is grateful for the information the trade has provided to enable a better understanding of the likely costs, benefits and detailed design issues involved with tax stamps. It also welcomes the trade's alternative proposal, in the form of a package of proposed new controls on the alcohol supply chain. **Having considered the options carefully, the Government has concluded that this package would be significantly less effective in tackling fraud than tax stamps. The Finance Bill will therefore legislate to enable the introduction of tax stamps from 2006-07.** However, in order to minimise and offset the compliance costs to the legitimate trade, the Government will:

- **freeze the duty on spirits for the remainder of this Parliament** – the longest duty freeze since the 1950s, so that by 2005-06 the total tax on standard bottle of spirits will be £1.33 lower in real terms than if duty had risen in line with inflation since 1997 and 36p lower than now, helping to absorb the costs associated with tax stamps;
- **establish a £3 million fund to provide targeted grants to UK-based alcohol traders making capital investment in approved tax stamping equipment**, subject to further detailed consultation with the trade;
- **meet the ongoing printing and distribution costs of tax stamps in full** and further examine the scope for reducing security costs, as part of detailed implementation discussions; and
- subject to further detailed consideration and discussion with the trade, seek to **operate a system requiring no advance payment for tax stamps** in order to minimise adverse cash flow impact. If such an approach proves unworkable, HM Customs and Excise will further examine the scope for extended deferment arrangements to accompany a pre-payment system.

**5.99** The Government will publish a full regulatory impact assessment, including its assessment of the trade's alternative proposals, alongside Finance Bill 2004.

**Rebated oils 5.100** The UK Oils Fraud Strategy was announced in Budget 2002 and is targeted specifically at the misuse of rebated oils. It is a combination of new regulatory regimes and enhanced law enforcement activity which aims to deter oils fraud by making it harder to commit the crime successfully and increasing the likelihood of getting caught and being subject to tough penalties.

**5.101** Budget 2004 announces an increase of rebated oils duty by 2.42 pence per litre narrowing the differential with main fuel duties by one penny, which will, when combined with the ongoing impact of other strategy measures, further reduce the potential for oils fraud and reinforce the approach to tackling it, assisting Customs in achieving the aim of an illicit oils market of no more than 2 per cent by 2006.

## Modernising and simplifying the tax system

**Self assessment 5.102** To simplify self assessment, over 400,000 people around the country will receive a simplified four page short self assessment tax return this April. This is a first step towards national rollout in April 2005, when around one and a half million taxpayers will benefit from the short tax return. The new form will be issued to people with simple tax affairs including employees, pensioners and small businesses. In addition, many more people are taking advantage of the Inland Revenue's electronic filing service. Of the 90.6 per cent of self assessment returns filed on time, over one million have been received electronically. At around 15 per cent of the total this represents a significant increase from the previous year.

**Residence and domicile 5.103** The Government is continuing to review the residence and domicile rules as they affect the taxation of individuals, and is considering various aspects of this issue in the light of the responses to the paper<sup>25</sup> published at Budget 2003. The Government remains determined to proceed on the basis of evidence and in keeping with its key principles. It would welcome further contributions to the debate, which will then be taken forward by the publication of a consultation paper setting out possible approaches to reform.

<sup>25</sup> *Reviewing the Residence and domicile rules as they affect the taxation of individuals: a background paper*, HM Treasury, April 2003.

- Stamp duty land tax 5.104** A modernised regime for stamp duty on property transactions was successfully introduced on 1 December 2003. However, certain transactions involving partnerships remained outside the new regime, creating ambiguity and opportunities for avoidance. Legislation will now be introduced from Royal Assent of Finance Bill 2004 to level the playing field between these partnerships transactions and transactions undertaken by individuals. No changes in stamp duty rates or thresholds are proposed in this Budget.
- Inheritance tax 5.105** In keeping with its desire to make the tax system fairer and easier to operate, the Government will greatly simplify the inheritance tax system for around 30,000 estates each year. From later this year, they will be able to use the simplified reporting procedures that already exist for smaller estates. To deter abuse of the simpler process, changes are being made to the penalty regime for inheritance tax to bring it more into line with that for income tax and capital gains tax.
- Accrued Income Scheme 5.106** *Options for reform of the Accrued Income Scheme*<sup>26</sup> published today, seeks views on how the Accrued Income Scheme (AIS) could be simplified while maintaining protection of revenues. The AIS prevents avoidance of income tax where interest bearing securities are bought or sold by individuals and trusts.
- Offshore funds 5.107** Following consultation in 2002, the Government announced in the 2003 Pre-Budget Report that legislation would be brought forward in the 2004 Finance Bill to revise the rules for determining whether or not an offshore fund qualifies for 'distributor status'. Measures will therefore be introduced to:
- remove outdated rules from the UK Equivalent Profits test, so that an offshore fund can compare its distributions against a measure of its income that is more in line with the income of an equivalent UK fund;
  - abolish restrictions on offshore funds' investments which have become out of line with the regulatory environment; and
  - allow sub-funds of umbrella funds, and separate share classes of funds or sub-funds to qualify without affecting the other parts of the fund or umbrella.
- Tobacco duties 5.108** Smoking remains the greatest cause of preventable illness and premature death in the UK. Maintaining high levels of tax helps to reduce overall tobacco consumption. Budget 2004 therefore announces that from 6pm on Budget day tobacco duties will be increased in line with inflation.
- Alcohol duties 5.109** The Government is committed to delivering a fairer balance in the burden of taxation falling on different alcoholic drinks and different types of drink producer. To increase fairness in the alcohol duty regime, and in addition to the spirits duty freeze for the remainder of this Parliament to help offset the compliance costs of tax stamps, Budget 2004 announces from midnight on Sunday 21 March the following alcohol duty changes:
- **the duties on beer and wine will increase in line with inflation**, adding one penny to a pint of beer and four pence to a standard 75cl bottle of wine; and
  - **the duties on cider and sparkling wine will be frozen.**

<sup>26</sup> *Options for the reform of Accrued Income Scheme*, HM Treasury and Inland Revenue, March 2004.

**Small Breweries' Relief** **5.II0** In July 2003 the Government asked for evidence to help it assess the effectiveness of the Small Breweries' Relief scheme.<sup>27</sup> Responses indicate that the scheme has exceeded its objectives of helping the smallest breweries to invest in product development, compete better in the market and so maintain the diversity of products available to the consumer, with small brewers reporting significant growth in beer production. However, in response to concerns expressed about the effect of losing the relief on small breweries that outgrow the scheme, the Government today announces that, **from 1 June 2004 the relief will be extended, on a tapered basis, to breweries producing up to 60,000 hectolitres**, doubling the volume of beer production that is eligible for some relief.

**Gambling** **5.III** Following consultation, the Government has decided to defer any reform of Amusement Machine Licence Duty (AML), and any further major reform of other gambling taxes, to align with the Gambling Bill. Examination of the future of gambling taxation will include:

- consideration of whether a gross profits tax structure for the lottery would be more efficient and provide a better basis for generating money for the good causes while protecting tax revenues. Furthermore, the Government intends that the same principles that apply to the existing National Lottery would apply to any Olympic themed lottery games;
- development of the Government's work with the machines sector, following this year's consultation on AML, and in the context of Gambling Bill proposals;
- re-examination of the tax treatment of Fixed Odds Betting Terminals (FOBTs), in light of the potential competition and machine definition issues they raise in a developing UK gambling industry;
- continuing work with the industry to settle a fair and equitable tax treatment for betting exchanges and their clients; and
- consideration of the appropriate tax treatment of hedged bets.

## TACKLING GLOBAL POVERTY

**5.II2** The Government is committed to reducing global poverty and the achievement of the Millennium Development Goals (MDGs), signed up to in 2000 by almost 190 countries. However, the international community is already not on track to meet these targets, most significantly in the commitment to reduce child mortality by two-thirds. More than 70 countries are unlikely to meet the target to achieve universal primary education by 2015 and while there has been a 10 per cent reduction of people living in extreme poverty in the last 10 years, such progress is very uneven with many countries failing to achieve the MDG of halving poverty by 2015. In the case of sub-Saharan Africa, poverty levels have actually risen.

**5.II3** One of the major reasons for this potential failure is lack of sustained resources needed to underpin all these targets for simultaneous investment in health, education, sanitation and economic development. It is estimated that the resources needed are at least \$50 billion per annum greater than current flows of aid, even after essential further action to improve the effectiveness of current aid to achieve both value for money and improved outcomes. These additional resources are also an essential counterpart to providing opportunities for trade (see below) by ensuring that low-income countries have the capacity, with adequate human capital and physical infrastructure, to expand their trade and benefit from access to international market opportunities.

<sup>27</sup>Small Breweries' Relief: A Call for Evidence, HM Customs and Excise, July 2003.

**UK aid commitment** **5.II4** The UK Government remains committed to the UN target for aid of 0.7 per cent of gross national income. As announced in the 2002 Spending Review, total UK aid in 2003-04 stands at 0.33 per cent of gross national income and will rise to 0.4 per cent by 2005-06, representing a near doubling of aid since 1997 and on course to exceed the EU target of 0.39 per cent by 2006.

**5.II5** However the scale of the challenge set out above shows that the gap in resources cannot be bridged in time to meet the MDGs by traditional funding and so the Chancellor has proposed that donor Governments while moving toward the agreed target of 0.7 per cent consider immediately setting up an International Finance Facility (see Box 5.2) which raised an additional \$50 billion per annum to 2015 as a sustainable financing vehicle to underpin the MDGs, provide and sustain greater debt relief and ensure the capacity as well as the access to trade.

### **Box 5.2 International Finance Facility**

**The International Finance Facility (IFF) is designed to deliver the additional, predictable finance necessary to making progress on meeting the MDGs. Based on long-term commitments of \$16 billion per annum pledged by donors in the Monterrey Consensus, the IFF would leverage in \$50 billion per year from the international capital markets.**

**Recognising the pressing need to deliver additional resources, the international community has mandated the World Bank and International Monetary Fund to look at innovative financing mechanisms including the UK Government's proposal for an IFF. The institutions are due to present an interim report at the Spring Meetings in 2004 with a full report at the Annual Meetings in autumn 2004.**

**International support for the IFF continues to grow. To address issues such as the case for bringing forward investment and to heighten support for the IFF, more than 60 countries have been invited to a Financing for Development conference, co-hosted by the Chancellor and the French Finance Minister which will be held in Paris on 8 April 2004. HM Treasury recently hosted a conference, sponsored by Lord Carey of Clifton and Lord Griffiths of Fforestfach, on Making Globalisation Work for All which examined the challenges of delivering the Monterrey Consensus. At the conference, the coalition of non-governmental organisations, faith leaders and figures from the business world reached a consensus requiring urgent action in trade reform and increasing aid to achieve the MDGs.**

**The Global Alliance for Vaccines and Immunisation (GAVI) has approached the UK to explore whether the IFF's frontloading principles can be applied to GAVI so as to increase the resources available to meet the international community's child mortality targets. The World Health Organisation estimates that the lives of three million children a year can be saved if universal access can be provided to all vaccines which are currently or soon to be available. GAVI is collaborating with the French and UK Governments to take this initiative forward.**

**5.II6** Sub-Saharan Africa in particular will not reach any of the MDGs by 2015 and on current trends is estimated not to achieve universal primary education until 2129, reduce child mortality by two-thirds before 2165 or halve the number of people living on less than \$1 per day before 2147. The Prime Minister has therefore launched a Commission for Africa to report in April 2005 during the UK's Presidency of the G8. The Chancellor will chair the Economy and Financing section of the Commission and will consider, amongst other issues, actions that need to be taken to increase aid and reform trade to enable Africa to meet its challenges.

**Debt relief 5.117** The Heavily Indebted Poor Countries (HIPC) Initiative is providing \$70 billion in debt relief to 27 of the poorest countries in the world and has helped increase their poverty-reducing expenditure by over \$2 billion a year since 1999. For example, debt relief has allowed Tanzania to abolish school fees in primary education and recruit 18,000 new primary school teachers. As a result of these measures enrolment rates have risen by 50 per cent and almost as many girls are now in school as boys reaching the 2005 target in the MDGs of gender equality in education.

**5.118** However, as set out in the recent World Bank Report, half of HIPC countries risk not having a sustainable exit from their debt burden mainly as a result of dependency on exports of commodities whose prices have fallen. The UK believes, therefore, that the international community will have to provide more resources – either through topping up generally or by specific country initiatives – and will have to ensure that debt is kept sustainable in the future by providing more aid in the form of grants. This will need resources which are additional to existing aid flows and the UK has therefore proposed that disbursements from the IFF should be provided mainly in the form of grants or debt relief.

**Trade 5.119** Trade is an essential engine of economic growth for both developed and developing countries. The World Bank has estimated that trade could lift an additional 140 million people out of poverty in developing countries. The Government remains fully committed to make the most of the Doha Development Agenda to improve developing countries' trading opportunities. Key to this agenda is securing ambitious reform of EU agriculture, discussed further in Box 5.3.

### **Box 5.3: Trade, agriculture and protectionism**

Developing countries are heavily dependent on agriculture. Agriculture accounts for around 12 per cent of gross domestic product (GDP) in low- and middle-income countries, and in some African countries over 50 per cent of GDP, compared to less than 2 per cent in the EU. Despite this, while 900 million in farming families in developing countries struggle to survive on less than \$1 a day, developed countries protect their agricultural sectors through high tariffs and subsidies worth nearly \$900 million a day. This is greater than the combined income of sub-Saharan Africa and six times the amount that developing countries receive in aid. Agricultural protectionism also harms rich countries' own economies. The Common Agricultural Policy (CAP) is estimated to cost EU taxpayers and consumers around \$100 billion a year through subsidies and high food prices. The poorest, who spend the greatest proportion of their income on food, are hit hardest by an implicit tax on food of around 26 per cent. Even after the benefits for farmers are taken into account, the cost to the UK economy has been estimated at some 0.5 per cent of GDP. Artificially high prices also tend to encourage over-intensive production and environmental damage.

Agriculture is not the only area of protectionism which harms poor countries – processed products also often face high tariff rates. This prevents developing countries from gaining maximum advantage from their resources. For example, in the EU and US cocoa beans enter tariff-free, but paste and chocolate face tariffs in excess of 15 per cent. A 2003 Oxfam investigation found that Vietnam – where 64 per cent of people live on less than \$2 a day – pays more in US customs duties than the Netherlands, despite accounting for a far smaller share of imports.

The Government is a leading advocate of reform of agricultural and trade policies which work against the poor. Last year, the EU agreed to reforms of the CAP which decouple the link between subsidies and production for many important products, so reducing incentives to over-produce. However, further reform is necessary, both to extend decoupling to the remaining sectors and to improve market access for developing countries. The Government continues to press for reform, particularly of the sugar and cotton sectors.

**Post-conflict support for Iraq** **5.120** The UK, as co-sponsor with the US of United Nations Security Council Resolution 1483, is responsible for the administration of Iraq as an occupying power, acting through the Coalition Provisional Authority (CPA). Under the November 2003 agreement with the Iraqi Governing Council, and following the UN fact-finding report of February 2004, the CPA will transfer sovereignty to an Interim Iraqi Government in July 2004. The UK Government's economic objectives are to strengthen the capacity of Iraq's own institutions, putting in place robust frameworks for future economic reform under a sovereign Iraqi Government, and reintegrating Iraq with the international community. Working with the Iraqi Ministry of Finance and Central Bank of Iraq, the UK has contributed to the work of the CPA, which has:

- introduced new public sector salary and pension scales which pay a decent wage and pension;
- introduced a single and secure new currency to replace the two currencies previously in circulation;
- modernised budget preparation methods, resulting in a unified budget for the first time in Iraq; and
- liberalized trade and encouraged investment, with a post-war tariff holiday succeeded by the introduction of a simple reconstruction levy from March 2004.

**5.121** The focus of the CPA's current economic work is to strengthen capacity at the Central Bank and Ministry of Finance to ensure that from July 2004 they can perform their core functions. At the same time, the Government continues to encourage the IMF and World Bank's efforts to provide technical assistance to Iraq, with a view to establishing a full programme and lending after July 2004.

**5.122** At the International Donor's Conference in Madrid in October 2003, donors pledged a total of at least \$32 billion to support Iraqi reconstruction, with the UK Government pledging a total of £544 million over the three years from 2003. In February, the Department for International Development published its Country Assistance Plan for Iraq and allocated an initial £65 million from the UK Madrid pledge to the International Reconstruction Fund Facility for Iraq, managed by the World Bank and the United Nations. The commitment announced at Madrid is in addition to the UK's significant contribution towards the costs of maintaining security. In addition, the UK's work on enforcing UN financial sanctions has led to the transfer of \$326 million of frozen financial assets of the former Iraqi regime to the Development Fund for Iraq.

**5.123** The Government is committed to a fair and sustainable solution to Iraq's debt problems and believes that creditors will need to write-off the vast majority of Iraq's debt. The UK actively supported the work of the US Presidential Envoy on Iraq Debt, Secretary James Baker, who has successfully brokered a G7 consensus that there should be substantial debt reduction for Iraq in the Paris Club in 2004. The Government will continue to work with international partners to broaden this emerging international consensus.

