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Direct taxes: rates and allowances 2003-04

This paper sets out the main changes to direct tax rates and allowances announced in the Budget of 9 April 2003. It lists the principal personal allowances which will be available against income tax in the tax year 2003-04, and it outlines the conditions necessary for eligibility for these allowances.

This paper provides a summary of the general tax position in straightforward cases only. It should be noted that this paper deals with tax allowances only. No reference is made to cash benefits provided under the social security system, or to the two tax credits – the child tax credit, and the working tax credit – introduced from April 2003.

Antony Seely

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Summary of main points

- Income tax on earned income is charged at three rates. For 2003-04 all three rates are unchanged: the starting rate is set at 10%, the basic rate at 22%, and the higher rate at 40%. The starting rate is charged on the first £1,960 of taxable income. The basic rate is charged on income in excess of this limit, up to the basic rate threshold of £30,500. Both thresholds have been increased in line with statutory indexation.

- The personal allowance is frozen at £4,615 for 2003-04. By contrast the two age-related personal allowances for older people have been increased above inflation: to £6,610 for people aged 65-74 years, and to £6,720 for people aged 75 years and over. This represents an increase in excess of inflation of £400 and £240 respectively. The income limit for the age-related allowances is increased to £18,300 in line with statutory indexation.

- Elderly taxpayers may be entitled to the married couple's allowance which was withdrawn from all couples who were aged under 65 on 6 April 2000. Only couples in which one partner was born on or before 5 April 1935 are entitled to receive an allowance. For 2003-04 this allowance is set at £5,565, or £5,635 if one partner is 75 or over. Both allowances are restricted to 10 per cent.

- The rates of National Insurance contributions (NICs) for employees and employers are both increased for 2003-04. For employees the rate of NICs is increased by 1 percentage point to a rate of 11% on all earnings between the primary threshold and the upper earnings limit; *in addition* NICs is charged at a new 1% rate on earnings *above* the upper earnings limit. For employers the rate of NICs is increased by 1 percentage point to a rate of 12.8% on earnings above the secondary threshold. The primary and secondary thresholds for NICs are both frozen in value for 2003-04, though the upper earnings limit is increased in line with inflation.

- This paper does not provide details of the cash benefits provided under the social security system. In addition, it only deals with tax allowances and 'wasteable' tax credits: those which are limited to the amount of the tax liability and therefore cannot give rise to a payment by the authorities to the taxpayer. 'Non-wasteable' tax credits are not so limited, so that the excess of the credit over the tax liability can be paid to the taxpayer.

- From April 2003 two new non-wasteable tax credits are introduced: first, the child tax credit, which incorporates the children's tax credit (a wasteable credit introduced in April 2001) with the income-related elements of support for children in income support, income-based jobseeker's allowance, working families' tax credit (WFTC) and disabled person's tax credit (DPTC); and, second, the working tax credit, which replaces the existing elements of support for adults and their childcare costs in both WFTC and DPTC. The WFTC and DPTC – both non-wasteable tax credits – had replaced the in-work benefits family credit and disability working allowance in October 1999. Further details on the new credits are given in, HM Treasury, *The child and working tax credits: the* *modernisation of Britain's tax and benefit system number ten*, April 2002 – which is available on the Treasury's internet site.[1]

1 www.hm-treasury.gov.uk/media//EE15F/new_tax_credits.pdf

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I Rates and thresholds

A. Income tax

Income tax on earned income is charged at three rates: the starting rate, the basic rate, and the higher rate. All three rates are unchanged for 2003-04: the starting rate of 10%, the basic rate of 22%, and the higher rate of 40%.

The 10% starting rate applies to taxable income up to £1,960. Taxable income excludes personal allowances, which represent the amount of money someone may receive free of tax. Taxable income in excess of the starting rate threshold is charged at the basic rate of 22%. The upper limit of the basic rate band is £30,500. Taxable income in excess of this second threshold is charged the higher rate of 40%. Both thresholds have been increased in line with inflation. The three tax rates and thresholds for 2003-04 are:

Taxable income	**Tax rate**
First £1,960	**10%**
£1,961 - £30,500	**22%**
Over £30,500	**40%**

The rates of income tax on savings income - other than dividend income - are unchanged for 2003-04: 10% for income in the starting rate band; 20% for income in the basic rate band; 40% for income above that. Generally savings income is taxed at source at 20%. Those only paying the starting rate can claim a repayment of tax from the Inland Revenue.[2] The rates of tax on dividend income are also unchanged: 10% for income below the basic rate limit, and 32.5% above that. In calculating tax liability, dividend and savings income is regarded as the 'top slice' of income, with dividends the highest.

B. National Insurance contributions

Employees are charged National Insurance contributions (NICs) on their earnings if their earnings exceed the lower earnings limit (LEL), which is set at £77 per week for 2003-04. A zero rate of NICs is charged on earnings between the LEL and the primary threshold (PT), which is set at £89.[3] Earnings above the PT are charged NICs at a rate of 11%, subject to a cap at the upper earnings limit (UEL), which is set at £595 per week. The rate of NICs is increased by 1 percentage point to 11% for 2003-04. In addition a new 1% rate of NICs is charged on earnings above the UEL for 2003-04. Employees contracted out of the state second pension (S2P) pay a reduced rate of NICs. Employers

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2 Alternatively they may apply to have their savings income paid gross of tax. An Inland Revenue helpline is available to give advice to those in this situation: 0845 980 0645. Further information is on the Inland Revenue's internet site at: www.inlandrevenue.gov.uk/taxback/index.htm.

3 No NICs are actually payable but a notional primary Class 1 NIC will be deemed to have been paid in respect of earnings between LEL and PT to protect benefit entitlement.

pay NICs on employee earnings at a rate of 12.8%, on earnings above the secondary threshold (ST), also set at £89 a week for 2003-04.[4] The rate of employer NICs is also increased by 1 percentage point for 2003-04.

The rates of NICs for employees and employers for 2003-04 are set out below:[5]

Total weekly earnings[1]	**Employee (primary) NICs rate**[2]	**Employer (secondary) NICs rate**[3]
£0 to £77 (LEL)	0%	0%
£77 to £89 (PT/ST)	0%	0%
£89 to £595 (UEL)	11%	12.8%
Above £595	1%	12.8%

[1] *The limits are defined as LEL - lower earnings limit; PT - primary threshold; ST - secondary threshold; and UEL - upper earnings limit.*
[2] *The contracted-out rebate for primary contributions in 2003-04 is 1.6 per cent of earnings between the LEL and UEL for contracted-out salary-related schemes (COSRS), and contracted-out money purchase schemes (COMPS).*
[3] *The contracted-out rebate for secondary contributions is 3.5 per cent of earnings between the LEL and UEL for COSRS and 1.0 per cent for COMPS. For COMPS, an additional age related rebate is paid direct to the scheme following the end of the tax year. For appropriate personal pensions, the employee and employer pay NICs at the standard, not contracted-out, rate. An age and earnings related rebate is paid direct to the personal pension provider following the end of the tax year.*

The additional 1 per cent national insurance contribution by employees and employers charged from April 2003 was announced in the 2002 Budget,[6] and implemented in the *National Insurance Contributions Act 2002*.[7]

II Personal allowances

All individuals receive a personal allowance which they can set against income tax, irrespective of sex or marital status. Two age-related additions are made to the allowance: the first, if someone is 65 or over, the second if they are 75 or over. Those born before 6 April 1935 may be eligible for two other allowances: the married couple's allowance and tax relief on maintenance payments. An allowance is also given to individuals who are blind. Income tax legislation requires the main allowances and thresholds to be increased in line with the Retail Prices Index (RPI) unless Parliament determines otherwise. This statutory

[4] Both the PT and ST are aligned with the personal tax allowance.
[5] HM Treasury, *Budget 2003*, HC 500 April 2003 p 189
[6] HC Deb 17 April 2002 cc 590-2
[7] The background to this measure, and the equivalent increase in NICs on the self-employed announced at the time, is examined in Library Research paper 02/32, *The National Insurance Contributions Bill*, 8 May 2002. An article on the impact of these tax changes is in the latest issue of the Library's *Economic Indicators* research paper (Library Research paper 03/33, 1 April 2003).

requirement - the so-called "Rooker-Wise" amendment - was introduced under section 22 of the *Finance Act 1977*.[8] The amendment was successfully made through the cross-party co-operation of Jeff Rooker and Audrey Wise with Nigel Lawson. All three argued that without indexation, inflation acted as an unauthorised, unintended and unknown increase in taxation. By ensuring that any real changes in allowances would have to be voted on, the amendment ensured changes in the income tax structure would be 'out in the open'.

Personal allowances should be increased by a percentage equivalent to the rise in the RPI rounded up to the nearest £10; the income limit for age allowances should be increased by a similar proportion but rounded up to the nearest £100. In the case of thresholds, changes must be rounded up to the nearest multiple of £10 (starting rate threshold) or £100 (basic rate threshold). When uprating the main allowances and thresholds, the relevant inflation rate taken is the increase in the RPI in the year to September. For the year to September 2002 the rate of inflation was 1.7%.[9]

A. Personal allowance

Every taxpayer resident in the United Kingdom is entitled to a personal allowance that can be set against any type of income for tax purposes. Two additional levels of the allowance are provided for the elderly. The allowance is not transferable between spouses.

These three allowances for 2003-04 are:

Under 65	**£4,615**
65 – 74	**£6,610**
75 and over	**£6,720**

The personal allowance is unchanged from 2002-03. The two age-related allowances have been increased by £510 and £350 respectively; this represents an increase in excess of inflation of £400 and £240.

The additional age allowances are reduced above a certain income limit by £1 for every £2 by which income exceeds the limit (this is explained below, in part II.B of this paper). In such cases only the extra allowance is withdrawn. No-one over the age of 65 receives less than the basic personal allowance.

8 Consolidated in section 257C of the *Income and Corporation Taxes Act (ICTA) 1988*. The statutory requirement to uprate the starting rate and basic rate thresholds in line with inflation unless Parliament determines otherwise is provided under section 1 of *ICTA 1988*.

9 *National Statistics*. The legislation is framed in terms of the consumer price index itself, rather than the RPI figure, and this may make a difference; notably, allowances which end in a 5 may continue to do so (for details see HM Treasury, *Tax Benefit Reference Manual*, 2002-03 edition paras 1.23-5).

B. Income limit for age-related allowances

Taxpayers claiming an age-related allowance whose income exceeds £18,300 for 2003-04 will have their allowance reduced by £1 for every £2 that their income exceeds this limit. This progressive reduction continues until the allowance is equal in value to that of the ordinary personal allowance, or, in the case of those taxpayers still entitled to the married couple's allowance (MCA), a 'minimum' allowance.[10] The income limit is increased by £400 in line with statutory indexation. For individual taxpayers qualifying for an age-related personal allowance, the benefit of the additional allowance will not be completely withdrawn until their total income reaches the following limits:[11]

65 – 74	**£22,290**
75 and over	**£22,510**

C. Blind person's allowance

Any person registered as blind is entitled to the blind person's allowance (BPA). The allowance is increased in line with inflation by £30 to £1,510 for 2003-04. The allowance is not restricted in value. If someone has insufficient income to make use of the allowance it can be transferred to a spouse.

D. Two transitional allowances for the elderly

Four allowances were withdrawn from April 2000: the married couple's allowance (MCA) for couples born after 5 April 1935; the additional personal allowance; the maintenance allowance for separated or divorced couples under 65; and the widow's bereavement allowance.[12] However, both the MCA and tax relief on maintenance payments were retained for individuals receiving these allowances, where either they, or their spouse/one-time spouse, had reached the age of 65 by the start of the tax year 2000-01; ie, they were born on or before 5 April 1935.

1. Married couple's allowance

A **married couple's allowance** is given to married couples in which at least one partner had reached 65 by 6 April 2000.[13] In line with the personal allowance, a higher allowance is

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[10] The continued provision of this allowance to people born before 6 April 1935 is examined in part II.D of this paper.

[11] Only the 'minimum' MCA is transferable between husband and wife. As a consequence, for the MCA the figures will depend on the income of the husband and the age of the older spouse.

[12] The abolition of these allowances was announced in the March 1999 Budget; for further details see *Direct taxes: rates & allowances 2000-01*, Library Research paper 00/38, 29 March 2000 pp 11-12.

[13] When a person born on or before 5 April 1935 newly gets married, that person or their spouse is entitled to claim the MCA.

given to couples in which at least one partner is 75 or over. For 2003-04 the two age-related allowances are:

One or both aged 68 – 74	**£5,565**
One or both aged 75 or over	**£5,635**

Both allowances are increased by £100 for 2003-04, in line with statutory indexation. Tax relief for these allowances is 'restricted' to 10 per cent. In effect taxpayers receive a credit worth 10% of the MCA to set against their final tax bill: ie, £557 in the case of the MCA for couples between 66 and 74.

The value of the MCA is gradually reduced for taxpayers earning above the income limit, in the same way as the age-related personal allowances (see Part II.B of this paper). The withdrawal of the MCA from elderly couples is subject to a minimum allowance set at £2,150 for 2003-04, restricted to 10 per cent.[14] No couple entitled to the allowance will receive less than this. In the first instance the MCA is given to the husband, though if couples elect, the minimum MCA can be transferred to the wife or split equally between spouses. Where a couple marry during the tax year the allowance is reduced by one twelfth for each complete tax month pre-marriage.

2. Tax relief for maintenance payments

Generally maintenance payments are made outside the tax system: those who make payments cannot claim them against tax, and those who receive them are not taxed on them. Separated or divorced individuals who pay maintenance direct to their ex-spouse under a legally binding agreement may qualify for a limited form of tax relief – often referred to as a '**maintenance allowance**' – provided that one or more of the parties reached 65 prior to 6 April 2000. This relief is set equal to the 'minimum' MCA that couples over 65 can receive (which is £2,150 restricted to 10 per cent for 2003-04). Individuals who make maintenance payments to a child, or to someone to whom they have not been married, do not qualify for this relief. Tax relief is withdrawn if the ex-spouse who receives maintenance remarries.[15]

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[14] The minimum amount of the MCA is also increased in line with statutory indexation for 2003-04.

[15] This relief is also given to those paying maintenance under arrangements set up before 15 March 1988, who benefited from transitional relief withdrawn in April 2000. Again, relief is only given if one or more of the parties reached 65 prior to 6 April 2000.

E. Summary table of the allowances

£

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
Personal allowance	4,195	4,335	4,385	4,535	4,615	4,615
" (65 - 74)	5,410	5,720	5,790	5,990	6,100	6,610
" (75 & +)	5,600	5,980	6,050	6,260	6,370	6,720
MCA (basic)	1,900*	1,970*	Withdrawn	Withdrawn	Withdrawn	Withdrawn
MCA (65 - 74)†	3,305*	5,125*	5,185*	5,365*	5,465*	5,565*
MCA (75 & +)	3,345*	5,195*	5,255*	5,435*	5,535*	5,635*
Income limit	16,200	16,800	17,000	17,600	17,900	18,300
BPA	1,300	1,380	1,400	1,450	1,480	1,510

* Relief restricted to 15 per cent for the tax years 1996-97 to 1998-99, and to 10 per cent for 1999-2000 to 2003-04.

† From 2000-01 the MCA is only given to couples in which at least one partner was born before 6 April 1935.

III Fringe benefits: company cars & free fuel

Generally individuals are taxed on the cash value of any fringe benefit they enjoy by virtue of their employment.[16] Special rules apply in evaluating the cash value of a company car: in brief, a normal minimum charge of 15% of the car's price applies to cars emitting CO_2 at or below a specified qualifying level – set at 155g/km for 2003-04. The percentage charge builds up in 1% steps for every additional full 5g/km over that level up to a maximum charge of 35% of the car's price.

The system for taxing company cars was reformed in April 2002; it is the Government's intention that the qualifying level of CO_2 emissions will gradually be reduced over the first few years of this reform, reflecting anticipated improvements in the fuel efficiency of new cars.[17] Cleaner, alternatively fuelled cars are entitled to a discount on this benefit charge; a supplementary charge is levied on diesel cars if they do not meet European Community standards for cleaner vehicles.[18]

New rules for determining the taxable benefit of free fuel provided for private motoring in a company car are introduced from April 2003, relating the benefit charge to CO_2 emissions.[19] The same percentage charge as used for company cars – starting at 15% and rising to 35% – is employed. To calculate the benefit charge on free fuel the percentage figure is multiplied against a set figure for the year; for 2003-04 this figure is £14,400. The 3 per cent supplement for diesels which do not meet Euro IV standards, and the reduced charge for alternatively fuelled cars, also apply.[20]

IV Pensions

The pension scheme earnings cap is increased in line with inflation by £1,800 to £99,000 for 2003-04. This is the maximum earnings from which contributions to a personal, occupational or stakeholder pension scheme can attract tax relief. The earnings cap generally applies to people who contribute to a personal pension scheme, joined an occupational scheme set up since 14 March 1989, or joined any occupational scheme from 1 June 1989 which was set up before 14 March 1989. Since April 2001 the cap has applied to people who contribute to stakeholder pension schemes.

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16 The cash value is added to their taxable income, and taxed accordingly; ie, taxed at the same rate as the rest of their income (22% or 40% depending on their circumstances). Benefits in kind are taxed if the person receiving them is a director, or an employee who earns £8,500 or more per year.

17 In the 2003 Budget the Government announced that the level of emissions qualifying for the minimum charge would be 145g/km in 2004-05 and 140g/km in 2005-06 (HC 500 April 2002 p 161).

18 The background to this reform is discussed in *Taxing company cars*, Library Research paper 02/10, 5 February 2002.

19 Previously individuals paid a fixed charge dependent on the engine size of the car they used. This change was announced in the 2002 Budget (HC 592 April 2002 p 135).

20 Further details on the benefit charge for both a company car and the provision of free fuel are given on the Inland Revenue's site at www.inlandrevenue.gov.uk/cars/index.htm.

V Charities

There is no general tax exemption or relief granted to taxpayers who make gifts to charities. Tax relief is provided through two schemes which cover regular donations made out of one's salary (Payroll Giving), and one-off cash gifts (Gift Aid).

Under the Payroll Giving scheme charitable donations are wholly deductible for income tax purposes, the relief being given through the PAYE system. The employer deducts the appropriate sum from a participating employee's pay, and passes it to an agency who distributes it to the charity or charities of the employee's choice. There are no minimum or maximum limits for donations under the scheme (a maximum limit of £1,200 a year applied prior to 6 April 2000).[21] Gift Aid allows income tax relief for single donations by individuals. When this relief was introduced in 1990, a minimum limit on donations was set at £600. Tax relief applies to a donation of any size, following the abolition of the minimum limit – then £250 – from 6 April 2000.[22] Tax relief for donations under a deed of covenant is no longer given, as the abolition of the Gift Aid minimum limit made this method of tax-privileged donation redundant.[23]

VI Capital gains tax

Capital gains tax (CGT) is charged on gains in excess of the annual exempt amount, which is increased in line with statutory indexation to £7,900 for 2003-04. Individuals may realise gains up to this threshold free of tax. For tax purposes, capital gains are treated as the top slice of income. The rates of CGT are the same as the rates of tax on savings income. For 2003-04 gains below the starting rate threshold of £1,960 are taxed at 10%. Gains between the starting rate threshold and basic rate threshold of £30,500 are taxed at 20%, and gains above this are taxed at 40%. Chargeable gains are tapered according to the length of time an asset has been held; the taper is more generous for business assets than non-business assets.[24]

VII Inheritance tax

Inheritance tax is levied on the value of a person's estate at the time of their death. Most large gifts made out of someone's estate within seven years of their death are treated as part of their estate for tax. The tax is charged at 40% above the tax-free threshold. The threshold is increased by £5,000 to £255,000 for 2003-04, in line with statutory indexation.

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[21] Further information is on the Revenue's site at: www.inlandrevenue.gov.uk/payrollgiving/index.htm.

[22] Details are given in the Inland Revenue leaflet, *Giving to charity by individuals IR65*, September 2000, available at: www.inlandrevenue.gov.uk/pdfs/ir65.pdf.

[23] For further background on the changes introduced in April 2000 see *Taxation of charities*, Library Research paper 01/46, 12 April 2001.

[24] The operation of the tax is relatively complex. An introductory guide is published by the Revenue: *Capital Gains Tax CGT1*, August 2002, available at: www.inlandrevenue.gov.uk/pdfs/cgt1.pdf.