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Direct taxes: rates and allowances 2008-09

This paper sets out the main changes to direct tax rates and allowances announced in the Budget of 12 March 2008. It lists the principal personal allowances which will be available against income tax in the tax year 2008-09, and it outlines the conditions necessary for eligibility for these allowances.

The paper provides a summary of the general tax position in straightforward cases only. It should be noted that it deals with tax allowances only. No reference is made to cash benefits provided under the social security system, or to child tax credit and working tax credit.

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Summary

- Income tax on earned income is charged at two rates: the basic rate and the higher rate. For 2008-09 the basic rate is cut from 22% to 20%; the higher rate is left unchanged at 40%. Tax is charged at the basic rate up to the higher rate threshold, which is set at £36,000 for 2008-09. The starting rate of 10%, which was introduced in April 1999, is withdrawn.

- The personal allowance is increased in line with price inflation to £5,435 for 2008-09. The two age-related personal allowances for older people have been increased in real terms by £1,180: to £9,030 for people aged 65-74 years, and to £9,180 for people aged 75 years and over. The income limit for the age-related allowances is increased to £21,800 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- Elderly taxpayers may be entitled to the married couple's allowance which was withdrawn from all couples who were aged under 65 on 6 April 2000.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 2008-09 this allowance is set at £6,535, or £6,625 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 unchanged for 2008-09. For employees the rate of NICs is set at 11% on all earnings between the primary threshold and the upper earnings limit, and at 1% on earnings *above* the upper earnings limit. For employers the rate of NICs is set at 12.8% on earnings above the secondary threshold. Both the primary and secondary thresholds (which are set equal to each other) are increased in line with inflation. The upper earnings limit is increased from £670 to £770.

- This paper does not provide details of the cash benefits provided under the social security system. In addition, it deals only 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. In April 2003 two new non-wasteable tax credits were introduced: child tax credit and working tax credit. Further details are published on HM Revenue & Customs internet site.[1]

[1] http://www.hmrc.gov.uk/taxcredits/

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I Rates and thresholds

A. Income tax

Income tax on earned income is charged at two rates: for 2008-09, these are the basic rate, which is cut from 22% to 20%, and the higher rate of 40%. The starting rate of 10% is withdrawn from 6 April 2008.

The 20% basic rate applies to taxable income up to £36,000. Taxable income excludes personal allowances, which represent the amount of money someone may receive free of tax. Taxable income in excess of this threshold is charged at the higher rate of 40%. This threshold has been increased in line with inflation.

2007-08		2008-09	
Taxable income	**Tax rate**	**Taxable income**	**Tax rate**
£0 - £2,230	**10%**		
£2,231 - £34,600	**22%**	**£0 - £36,000**	**20%**
Over £34,600	**40%**	**Over £36,600**	**40%**

The new two-rate structure covers all non-savings income: earnings, pensions, taxable social security benefits, trading profits and income from property.

The 10% starting rate is retained for savings income: that is, bank and building society interest. For 2008-09 savings income is charged at 10% for income up to a new starting rate limit, set at £2,320. Above this limit savings income is charged tax at the basic rate of 20%, up to the higher rate threshold of £36,000. Savings income above this limit is charged at the 40% higher rate. Generally savings income is taxed at source at 20%. Individuals with too little income to pay tax, or those paying only the starting rate, can claim a repayment of tax from HM Revenue & Customs.[2] The rates of tax on dividend income are unchanged: 10% for income below the basic rate limit, and 32.5% above that.

In calculating tax liability, dividend and savings income are regarded as the 'top slice' of income, with dividends the highest. As a consequence, if an individual's non-savings income exceeds the new starting rate limit for savings, then the 10% starting rate will not be available for their savings income.

B. National Insurance contributions

Employees pay National Insurance contributions (NICs) on their earnings if they exceed the lower earnings limit (LEL), which is set at £90 per week for 2008-09. A zero rate of NICs is charged on earnings between the LEL and the primary threshold (PT), which is

[2] Alternatively individuals may apply to have their savings income paid gross of tax. HM Revenue & Customs provide an online calculator to help individuals assess if they should do this - http://www.hmrc.gov.uk/calcs/r85.htm - and a helpline providing advice on this issue (0845 980 0645).

set at £105 per week.[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 £770 per week. Earnings above the UEL are charged NICs at a rate of 1%. Employees contracted out of the state second pension (S2P) pay a reduced rate of NICs. Employers pay NICs on employee earnings at a rate of 12.8% on earnings above the secondary threshold (ST), also set at £105 a week for 2008-09.[4]

The LEL, PT and ST are all increased in line with inflation. The UEL is increased by an additional £75 in real terms, as a first step toward aligning this limit with the higher rate threshold – the point at which taxpayers start to pay the higher rate of income tax.[5]

The rates of NICs for employees and employers for 2008-09 are set out below:[6]

Earnings[1] **£ per week**	**Employee (primary) NIC rate (per cent)[2]**	**Employer (secondary) NIC rate (per cent)[3]**
Below £90 (LEL)	0%	0%
£90 to £105 (PT/ST)	0%[4]	0%
£105 to £770 (UEL)	11%	12.8%
Above £770	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 2008-09 is 1.6 per cent of earnings between the LEL and UEL for contracted-out salary-related schemes (CORS) and contracted-out money purchase schemes (COMPS).*
[3] *The contracted-out rebate for secondary contributions is 3.7 per cent of earnings between the LEL and UEL for CORS and 1.4 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.*
[4] *No NICs are actually payable but a Class 1 NIC is treated as having been paid in respect of earnings between the LEL and PT to protect benefit entitlement.*

II Personal allowances

All individuals irrespective of sex or marital status receive a personal allowance which they can set against income tax. 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.

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3 A notional primary Class 1 NIC is deemed to have been paid in respect of earnings between LEL and PT to protect benefit entitlement.
4 Both the PT and ST are aligned with the personal tax allowance.
5 This reform is discussed in, *National Insurance Contributions Bill*, Library Research paper 07/88, 11 December 2007.
6 HM Treasury, *Budget 2008*, HC 388 March 2008 p 114

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 requirement - the so-called “Rooker-Wise” amendment - was introduced under section 22 of the *Finance Act 1977*.[7] The amendment was successfully made through the cross-party co-operation of Jeff Rooker, Audrey Wise and 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’.

When allowances and thresholds are increased in line with the RPI, they are rounded up to the nearest £10 or £100. For personal allowances this rounding amount is set at £10; for the income limit for age allowances and the higher rate threshold it is set at £100. When uprating the main allowances and thresholds, the relevant inflation rate is the increase in the RPI in the year to September. For the year to September 2007 the rate of inflation was 3.9%.[8]

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 2008-09 are:

Under 65	**£5,435**
65 – 74	**£9,030**
75 and over	**£9,180**

The personal allowance is increased in line with inflation from 2007-08. The two age-related allowances are increased by £1,180 more than indexation requires.

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 in more detail below). In such cases only the extra allowance is withdrawn. No-one over the age of 65 receives less than the basic personal allowance.

B. Income limit for age-related allowances

Taxpayers claiming an age-related allowance whose income exceeds £21,800 for 2008-09 will have their allowance reduced by £1 for every £2 that their income exceeds this limit.

[7] The statutory requirement to uprate allowances and threshold, is consolidated in ss 57 & 21 of the *Income Tax Act 2007*.

[8] Office for National Statistics press notice, *Balanced price changes leave CPI inflation unchanged*, 16 October 2007. Uprating is calculated using the values of the RPI for the September preceding the Budget and the previous September. For details see, HM Treasury, *Tax Benefit Reference Manual* 2007-08 edition paras 1.16-19.

This progressive reduction continues until the allowance is equal in value to the ordinary personal allowance, or, in the case of those taxpayers still entitled to the married couple's allowance (MCA), a 'minimum' allowance.[9] The income limit is increased by £900 in 2008-09 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:

65 – 74	**£28,990**
75 and over	**£29,290**

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 £70 to £1,800 for 2008-09. 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.[10] 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

Married couples in which at least one partner reached 65 by 6 April 2000 are still entitled to claim a **married couple's allowance**.[11] In line with the personal allowance, a higher allowance is given to couples in which at least one partner is 75 or over. For 2008-09 the two age-related allowances are:

One or both aged 73 – 74	**£6,535**
One or both aged 75 or over	**£6,625**

9 The continued provision of this allowance to people born before 6 April 1935 is dealt with in part II.D of this paper.

10 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.

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

The allowances are increased by £250 and £260 respectively, 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, £654 in the case of the MCA for couples between 73 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 p9 of this paper). The withdrawal of the MCA from elderly couples is subject to a minimum allowance set at £2,540 for 2008-09, restricted to 10 per cent.[12] No couple entitled to the allowance will receive less than this. Where a couple marry during the tax year the allowance is reduced by one twelfth for each complete tax month pre-marriage. 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.

On 5 December 2005 the *Civil Partnership Act 2004* came into force, creating a new legal status for same-sex couples wishing to have their relationships recognised in law. In March 2005 the Government announced that civil partners would be treated the same as married couples for tax purposes. As a consequence, civil partners may claim the MCA, *provided* – as with married couples – one or more partner was born before 6 April 1935.

The rules regarding the MCA for civil partners, and marriages after 5 December 2005, are slightly different regarding the initial right of claim: in the first instance the civil partner or spouse with the higher income receives the MCA though again, if couples elect, the minimum MCA may be split, or transferred to the partner or spouse with the lower income. Spouses married before 5 December 2005 who are in receipt of the MCA may elect to be covered by these new rules.[13]

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 £2,540 restricted to 10 per cent for 2008-09). 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.[14]

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[12] The minimum amount of the MCA is also increased in line with statutory indexation for 2008-09.

[13] For details see HM Revenue & Customs, *Independent Taxation Manual* paras IN511A-IN518C

[14] 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.

III Main personal income tax rates and allowances since 1990/91

Table 1

Main income tax rates and allowances: 1990/91-2008/09

	Allowances/Limits (£ per annum)			Rates		
	Personal Allowance	Lower/ Starting Rate Limit	Basic Rate Limit	Lower/ Starting	Basic	Higher
1990/91	3,005	n/a	20,700	n/a	25%	40%
1991/92	3,295	n/a	23,700	n/a	25%	40%
1992/93	3,445	2,000	23,700	20%	25%	40%
1993/94	3,445	2,500	23,700	20%	25%	40%
1994/95	3,445	3,000	23,700	20%	25%	40%
1995/96	3,525	3,200	24,300	20%	25%	40%
1996/97	3,765	3,900	25,500	20%	24%	40%
1997/98	4,045	4,100	26,100	20%	23%	40%
1998/99	4,195	4,300	27,100	20%	23%	40%
1999/00	4,335	1,500	28,000	10%	23%	40%
2000/01	4,385	1,520	28,400	10%	22%	40%
2001/02	4,535	1,880	29,400	10%	22%	40%
2002/03	4,615	1,920	29,900	10%	22%	40%
2003/04	4,615	1,960	30,500	10%	22%	40%
2004/05	4,745	2,020	31,400	10%	22%	40%
2005/06	4,895	2,090	32,400	10%	22%	40%
2006/07	5,035	2,150	33,300	10%	22%	40%
2007/08	5,225	2,230	34,600	10%	22%	40%
2008/09	5,435	n/a	36,000	n/a	20%	40%

Notes: (a) For 2008/09, a 10% starting rate of income tax is retained for savings income. See text for further details.

Sources: Budget 2008, HM Treasury, HC 388 2007-08
Tax Benefit Reference Manual: 2006-07, HM Treasury, 2006

Table 2

Age-related allowances: 1990/91-2008/09

£ per annum

	Personal		Married couple's (a)	
	65-74	75+	65-74	75+
1990/91	3,670	3,820	2,145	2,185
1991/92	4,020	4,180	2,355	2,395
1992/93	4,200	4,370	2,465	2,505
1993/94	4,200	4,370	2,465	2,505
1994/95	4,200	4,370	2,665	2,705
1995/96	4,630	4,800	2,995	3,035
1996/97	4,910	5,090	3,115	3,155
1997/98	5,220	5,400	3,185	3,225
1998/99	5,410	5,600	3,305	3,345
1999/00	5,720	5,980	5,125	5,195
2000/01	5,790	6,050	5,185	5,255
2001/02	5,990	6,260	5,365	5,435
2002/03	6,100	6,370	5,465	5,535
2003/04	6,610	6,720	5,565	5,635
2004/05	6,830	6,950	5,725	5,795
2005/06	7,090	7,220	5,905	5,975
2006/07	7,280	7,420	6,065	6,135
2007/08	7,550	7,690	6,285	6,365
2008/09	9,030	9,180	6,535	6,625

Notes: (a) Relief restricted to 20 per cent in 1994/95, 15 per cent from 1995/96 to 1998/99, and to 10 per cent from 1999/00. Since 2000/01 the MCA has only been given to couples in which at least one partner was born before 6 April 1935.

Sources: Budget 2008, HM Treasury, HC 388 2007-08
Tax Benefit Reference Manual: 2006-07, HM Treasury, 2006

IV 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.[15] 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 135g/km for 2008-09. 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. From April 2008 a lower 10% rate applies to cars with CO_2 emissions of 120g/km or less.

The system for taxing company cars was reformed in April 2002. The qualifying level of CO_2 emissions was set initially at 165g/km, and has been reduced gradually each year, reflecting improvements in the fuel efficiency of new cars.[16] There are certain supplements and reductions to the tax charge to take account of different fuels.[17]

In April 2003 the rules for determining the taxable benefit of free fuel provided for private motoring in a company car were also changed so that the benefit charge was related to the level of CO_2 emissions. The same percentage charge as used for company cars – starting at 15% and rising to 35% – is used. To calculate the benefit charge the percentage figure is multiplied against a set figure for the year; for 2008-09 this figure is £16,900.

V Pensions

In the 2004 Budget the Government announced a simplification in the tax treatment of pensions to come into effect from 6 April 2006 ('A-day'). This reform in the tax rules sets two limits for an individual's tax-privileged pension saving: an annual allowance for the amount of contributions that may be made over a year, and a lifetime allowance setting an overall ceiling on the amount of tax-privileged pension savings that someone may accrue. For 2008-09 these allowances are set at £235,000 per year and £1.65 million respectively. Full details are published on HMRC's internet site.[18] Prior to this, an annual limit – the pension scheme earnings cap – was set on the maximum earnings from which contributions to a personal, occupational or stakeholder pension scheme could attract tax relief.

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15 The cash value is added to their taxable income, and taxed accordingly; ie, taxed at the same rate as the rest of their income (20% 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.

16 The qualifying level of emissions is to be cut from 135g/km to 130g/km from 2010-11 (HC 388 March 2008 p121).

17 Guidance on these rules is given on HMRC's site at: http://www.hmrc.gov.uk/cars/index.htm

18 http://www.hmrc.gov.uk/pensionschemes/pts.htm

VI 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 which distributes it to the charity or charities of the employee's choice. There are no minimum or maximum limits for donations under the scheme.[19]

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.[20] Under the scheme charities claim repayment of basic rate tax on donations. Higher rate taxpayers claim higher rate tax relief on their gifts. As noted above, the basic rate of income tax is cut from 22% to 20% from 6 April 2008. Charities will be entitled to a transitional relief for three years which preserves the value of tax relief at 22%. This transitional relief will cover donations made between 6 April 2008 and 5 April 2011.[21]

VII 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 £9,600 for 2008-09. Individuals may realise gains up to this threshold free of tax.[22]

A series of changes are made to the tax from 6 April 2008. For 2008-09 CGT is charged at the single headline rate of 18%. Prior to this capital gains were treated as the top slice of income, and the tax was charged at the same rates of tax as savings income (10%, 20% and 40%). Two reliefs for CGT are withdrawn – taper relief and indexation allowance. Finally, a new relief – entrepreneurs relief – is introduced, available on the gains made by individuals from dispose of the whole or part of a trading business, or of shares in a trading company in which they have a qualifying interest.[23]

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19 A maximum limit of £1,200 a year applied prior to 6 April 2000. Further information is on HMRC's site at: http://www.hmrc.gov.uk/payrollgiving/index.htm.

20 The abolition of the minimum limit made the separate tax relief given for donations under a deed of covenant redundant, and it was withdrawn at this time. Further information is on HMRC's site at: http://www.hmrc.gov.uk/charities/giving-to-charities-indiv.htm

21 HC 388 March 2008 para 5.50

22 An introduction to the tax is given in HM Revenue & Customs, *An introduction to Capital Gains Tax*, June 2007. Available at: http://www.hmrc.gov.uk/guidance/cgt-introduction.pdf

23 Further details of this reform are collated on HMRC's site at: http://www.hmrc.gov.uk/cgt/index.htm

VIII Inheritance tax

Inheritance tax is levied on the value of a person's estate at the time of their death.[24] 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 allowance. This allowance is increased by £12,000 to £312,000 for 2008-09.[25]

Certain gifts are exempt from tax irrespective of their size, and irrespective of whether they are made during one's life, or made under the terms of one's will – including gifts made to one's spouse or civil partner. An important extension in this relief was announced in the *Pre Budget Report* in October 2007. Widows, widowers and civil partners are entitled to use the share, if any, of their partner's tax-free allowance which was unused when they died, to set against tax on their own estate. This transferable allowance is available to all survivors of a marriage or civil partnership who die on or after 9th October 2007 – whenever their first partner died.[26]

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[24] HMRC publish an online *Customer Guide to Inheritance Tax* on their site at: http://www.hmrc.gov.uk/cto/customerguide/page1.htm

[25] In the 2007 Budget the Government had announced this allowance would be set at £312,000 for 2008-09, £325,000 for 2009-10 and £350,000 for 2010-11 (HC 342 March 2007 para 5.121).

[26] Further information is provided on HMRC's site at: http://www.hmrc.gov.uk/cto/iht/tnrb.htm