Personal Tax Allowances & Reliefs 1996-97

Research Paper 95/120

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This paper sets out the main changes to the personal tax allowances and reliefs announced in the Budget of 28 November 1995. It lists the principal personal allowances which will be available against income tax in the tax year 1996-97, and it outlines the conditions necessary for eligibility for these allowances. As such, the paper provides a summary of the general tax position in straightforward cases only. It should be stressed that this paper deals only with tax allowances. No reference is made to cash benefits provided under the social security system or to national insurance contributions.

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A. Rates and Thresholds

The basic rate of income tax will be cut by 1% to 24% for 1996-97. The lower and higher rates of income tax are to be unchanged, and remain at 20% and 40% respectively. The lower rate of 20% will apply to the first £3,900 of taxable income - an increase of £700 - £500 above the increase in line with statutory indexation. The basic rate band is increased by £1,200 to £25,500 - which is £200 more than the increase under statutory indexation.

Taxable Income £	Tax Rate
First £3,900	**20%**
£3,901 - £25,500	**24%**
Over £25,500	**40%**

B. Personal Allowances

The statutory requirement to uprate personal allowances in line with inflation - the so-called "Rooker-Wise" amendment - was introduced under section 22 of the *Finance Act 1977*, and is consolidated in section 257C of the *Income and Corporation Taxes Act (ICTA) 1988*. 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 an unknown increase in taxation; in other words, taxation 'by stealth'. By ensuring that any real changes in allowances would have to be voted on, the amendment would ensure changes in the tax structure would be 'out in the open'. At the time Mr Lawson noted, "this does not hamstring the Chancellor in any way except to remove a bias which is there at present. It alters the political context and it will therefore have real consequences."[1]

These provisions were amended by section 107 of the *Finance Act 1993*, to take account of the Budget being moved from March to November. Personal allowances should be increased by a percentage equivalent to the rise in the retail price index (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. When uprating allowances, the relevant inflation rate taken is the increase in the RPI in the year to September, rather than the year to December as before. For the year to September 1995, the inflation rate has been 3.9%.

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1 HC Deb 25.7.77 cc 94-95

The ordinary personal allowance is to be increased by £240 for 1996-97, £100 more than the increase under statutory indexation. The age-related personal allowances are to be increased by £100 in excess of statutory indexation as well. The married couple's allowance, and those allowances linked to it, are all to be increased in line with inflation.

1. Personal Allowance

Every taxpayer resident in the United Kingdom is entitled to a personal allowance to be set against any type of income including investment income. There are three different levels:

Under 65	**£3,765**
65 - 74	**£4,910**
75 and over	**£5,090**

All three allowances are to be increased by an additional £100 on top of the increase under statutory indexation. The basic personal allowance rises by £240; the allowance for those aged between 65 and 74 rises by £280; and the allowance for those aged 75 and over rises by £290. The entitlement to age allowance is determined separately for each spouse dependent on their own age. The extra age allowance is reduced above a certain income limit by £1 for every £2 over the limit (see section **B3**). However no taxpayer receives less than the basic personal allowance available to those under 65. The personal allowance is **not** transferable between spouses.

2. Married Couple's Allowance

A married couple's allowance (MCA) is given to all married couples. It can be claimed by either spouse, or divided between them. If no preference is expressed, the allowance is given to the husband. The wife has the right to claim half the MCA; couples must make a joint election if she is to claim the entire allowance.

An additional allowance is given to couples in which at least one partner is over 65 years old. A second higher rate is given if one partner is over 75. However only the basic MCA is transferable between husband and wife; not the higher rates.

The ordinary MCA and the age-related allowances for 1996-97 are set out below:

Both aged under 65	**£1,790**
One or both aged 65 - 74	**£3,115**
One or both aged 75+	**£3,155**

The MCA is reduced by one twelfth for each complete tax month pre-marriage. The higher allowances for those over 65 are reduced above a certain income limit by £1 for every £2 of excess income (see section **B3**).

In the March 1993 Budget the then Chancellor (Norman Lamont) announced that the MCA would be restricted to 20 per cent from 6 April 1994, so that its money value would be the same for all taxpayers whatever their marginal rate of tax. Personal allowances are worth more to higher rate taxpayers, since they represent a fixed sum which is exempted from tax at an individual's marginal tax rate. The basic MCA when set at £1,720 was worth £688 for those whose marginal rate was 40 per cent; whereas it was only worth £344 for 20 per cent taxpayers. Restricting the allowance to 20 per cent meant that all taxpayers received £344 as a deduction from their final tax bill. In effect the allowance has become more like a tax credit.

In the November 1993 Budget Kenneth Clarke announced that all three married couple's allowances were to be further restricted to 15 per cent for 1995-96. The same 15 per cent restriction will apply to these allowances for 1996-97. As a result, the ordinary MCA will be worth £268.50 to all taxpayers. The same restriction applies to the additional personal allowance, and to the widow's bereavement allowance (these allowances are discussed below).

As a result of the introduction of independent taxation in April 1990, transitional allowances were introduced to minimise the loss faced by those couples where the wife was the breadwinner, and those couples where the wife was in a higher age allowance band than her husband. These arrangements will affect fewer people as the years go by. Details are given in *Independent Taxation* Research Note 90/9 5 February 1990.

3. Income Limit for Age Allowance

Taxpayers qualifying for age allowance whose income exceeds £15,200 for 1996-97 will have their allowance reduced by £1 for every £2 that income exceeds the limit. This progressive reduction continues until the allowance is equal in value to that of the ordinary personal allowance or the basic married couple's allowance. The income limit has been increased in line with inflation, from the limit of £14,600 for 1995-96.

For individual taxpayers qualifying for an age-related personal allowance the benefit of the allowance will not fall out until the following levels:

65 - 74	**£17,490**
75 and over	**£17,850**

For the married couple's allowance, the figures will depend on the age of the husband and of the oldest spouse. The age-related personal allowance is reduced **before** the age-related married couple's allowance, when any individual's tax bill is calculated.[2]

4. Additional Personal Allowance

An additional personal allowance (APA) is available in respect of individuals caring for children, equal in value to the ordinary married couple's allowance: £1,790 for 1996-97, restricted to 15 per cent. The child may be the claimant's natural or adopted child, or simply a child maintained at the claimant's expense (e.g. fostered). The child has to be under 18, unless he or she is in full-time education or in an apprenticeship of at least two years' duration. Those eligible for the APA are:

- a woman who is not, throughout the tax year in question, married and living with her husband.

- a man who is not, for all or part of the tax year in question, married and living with his wife.[3]

- a man who is, for all or part of the tax year in question, living with his wife, if she is totally incapacitated by physical or mental infirmity throughout the tax year (of course, in this case, the allowance would be given in addition to the married couple's

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2 Under section 257A(5)(b) of *ICTA 1988*

3 Provided he is not entitled to the transitional tax relief given to couples who separated before 6 April 1990.

allowance). Notably married women caring for their incapacitated spouse are not eligible for the allowance.

Single or divorced women, as well as widows, widowers, and single men, may claim the APA, provided they are taking care of at least one child (only one allowance is paid, irrespective of the number of children cared for by the claimant). If both parents, living apart, claim the allowance in respect of the same child, then they may elect to have it split between them. If they cannot agree, the allowance is split in proportion to the amount of time each parent spends with the child.[4]

5. Spouse's Transitional Exemption

The tax treatment of maintenance was changed substantially by provisions in the *Finance Act 1988*. Previously, those providing maintenance could apply for tax relief at their marginal rate of tax on their payments. The person receiving maintenance - ex-spouse or child - would be taxed on this income. The 1988 reform removed these transactions from the tax system. Those who make payments cannot claim them against tax, and those who receive them are not taxed on them. This applies to all maintenance payments made under a court order, a Child Support Agency assessment, or other type of legally binding agreement, made after 15 March 1988.

Separated or divorced individuals who pay maintenance direct to their ex-spouse qualify for a limited form of tax relief, sometimes called a 'maintenance allowance', equivalent to the married couple's allowance (i.e. an allowance of no more than £1,790). This relief is not extended to those making maintenance payments to an ex-partner, rather than to an ex-spouse, and it does not cover maintenance paid to children. Individuals may claim relief for payments made to more than one ex-spouse, but however many people they make payments to, the total amount of relief given in any one tax year is the same. Tax relief is withdrawn if the ex-spouse who receives maintenance remarries. Relief has been restricted in the same way as the married couple's allowance: to 20 per cent for 1994-95, and to 15 per cent for 1995-96 and 1996-97.

Under agreements made before 15 March 1988, the payer will continue to receive tax relief at the level he or she was allowed in 1988-89, through the PAYE system. Tax relief on the first £1,790 of maintenance paid is restricted to 15 per cent for 1996-97. Those who receive maintenance under the old system receive it gross. Where payments are made direct to an ex-spouse, the first £1,790 may be received tax free (this relief has not been restricted).

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[4] Under section 260 of *ICTA 1988*.

6. Widows Bereavement Allowance

The widows bereavement allowance (WBA) is intended to relieve some of the financial distress of bereavement. It is set equal to the basic married couple's allowance. The WBA may be claimed as well as the additional personal allowance, and, of course, the personal allowance. The allowance is available from the date of the death to the end of the following tax year, and applies against the widow's own income in this period. There is no corresponding allowance for widowers.

7. Blind Person's Allowance

Any person registered as blind is entitled to the blind person's allowance (BPA). The allowance is worth £1,250 for 1996-97, having been increased in line with inflation on the previous year. Unlike the married couple's allowance, and those allowances linked to it, the BPA is not restricted in value. If the allowance is not used, it can be transferred to a spouse.

Summary Table of the Allowances

£	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
Personal Allowance	3,295	3,445	3,445	3,445	3,525	3,765
" (65 - 74)	4,020	4,200	4,200	4,200	4,630	4,910
" (75 & +)	4,180	4,370	4,370	4,370	4,800	5,090
MCA (basic)	1,720	1,720	1,720	1,720*	1,720*	1,790*
MCA (65 - 74)	2,355	2,465	2,465	2,665*	2,995*	3,115*
MCA (75 & +)	2,355	2,505	2,505	2,705*	3,035*	3,155*
APA	1,720	1,720	1,720	1,720*	1,720*	1,790*
WBA	1,720	1,720	1,720	1,720*	1,720*	1,790*
Income Limit	13,500	14,200	14,200	14,200	14,600	15,200
BPA	1,080	1,080	1,080	1,200	1,200	1,250

* Relief restricted to 20 per cent in 1994-95 and to 15 per cent in both 1995-96 and 1996-97.

C. Benefits - Company Cars

In April 1994 the system of car benefit charges - based on the size of a car's engine - was replaced by a new system, based on the car's list price. A charge of 35 per cent of the price of a car is made, with discounts for business mileage and older cars. The car fuel charges for 1996-97 will increase by 5 per cent for both petrol and diesel cars. The intention is to increase the tax charge on the benefit of free fuel in line with the prices other drivers pay for their fuel. The scale charges are:

PETROL CARS		DIESEL CARS	
Engine size cc	**Scale charge £**	**Engine size cc**	**Scale charge £**
0 - 1,400	**710**	**0 - 2,000**	**640**
1,400 - 2,000	**890**	**2,001 -**	**820**
2,001 -	**1,320**		

D. Pensions

The pension scheme earnings cap will be increased in line with inflation, to £82,200 for 1996-97. This is the maximum earnings from which contributions to a personal or occupational pension scheme can attract tax relief.

E. Charities

There is no general tax exemption or relief granted to taxpayers who make gifts to charities, though there are specific reliefs covering regular donations made out of one's salary (payroll giving), and one-off cash gifts of a minimum size (Gift Aid), as well as to covenanted donations.

The payroll giving scheme is designed to encourage employees to make contributions to charity. The maximum amount which an employee can give is to be £1,200 per year from 6 April 1996. This represents an increase of £300 on the previous annual limit set by the *Finance Act 1993*. The annual amount paid in this way is 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. Gift Aid allows income tax relief for single donations by individuals. When this relief was introduced, the minimum limit was £600; the current minimum is £250, set by the *Finance Act 1993*.

F. Mortgages and Health Insurance

There is no change to the £30,000 limit on loans qualifying for interest relief for the purchase of a main residence. Tax relief on mortgage interest (MIRAS) was limited to the basic rate of income tax from 6 April 1991. Relief was restricted to 20 per cent from 6 April 1994, and to 15 per cent from 6 April 1995. MIRAS remains restricted to 15 per cent for 1996-97.

Tax relief has been given on premiums paid to private health schemes for those aged 60 and over since April 1990. The administrative arrangements are similar to the MIRAS scheme as premiums are paid net of tax. From 6 April 1994, relief has been restricted to the basic rate of 25 per cent.

G. Long Term Care

The provision of state benefits to meet the cost of someone's care in residential and nursing homes is dependent on the savings they possess. To date only those with assets less than £3,000 make no contribution to the cost of their care from their capital. Those with assets greater than £8,000 receive no state aid at all. It is proposed that these thresholds are increased from April 1996 (sooner if practicable). The lower threshold is to rise to £10,000; the upper threshold is to rise to £16,000.

Benefits paid by certain kinds of long term care insurance are to be exempt from tax from 6 April 1996. Tax-exempted policies will be those which provide benefits to meet the cost of the provision of care in the event of accident, sickness, disability, but only where policies are taken out before the need for care becomes apparent.

H. Capital Gains Tax

The annual exempt amount has been increased in line with statutory indexation, to £6,300 for individuals, in accordance with the indexation of thresholds for capital taxes incorporated in sections 80 and 91 of the *Finance Act 1982*. Gains are then taxed at one's marginal tax rate.

I. Inheritance Tax

Inheritance tax is levied on the value of a person's estate at the time of their death. Generally, personal gift giving is free from tax. However most gifts made out of someone's estate within seven years of their death are assessed as part of that person's estate, and are liable to tax as well. The tax is charged at 40 per cent above the tax-free threshold. This is increased substantially, from £154,000 to £200,000 for 1996-97. Had the threshold been increased in line with inflation, it would only have gone up to £160,000.

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