Personal Tax Allowances & Reliefs 1997-98

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This paper sets out the main changes to the personal income tax allowances and reliefs announced in the Budget of 26 November 1996. It lists the principal personal allowances which will be available against tax in the tax year 1997-98, 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.

Antony Seely
Business & Transport Section

House of Commons Library

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A. Rates and Thresholds

Income tax is charged at three rates - the lower rate, the basic rate, and the higher rate - on three bands of taxable income. Taxable income excludes personal allowances, which represent the amount of money someone may receive free of tax. The basic rate of income tax will be cut by 1% to 23% for 1997-98. The lower and higher rates of income tax are to be unchanged, and remain at 20% and 40% respectively.

The first £4,100 of an individual's taxable income is charged the lower rate for 1997-98. The lower rate band has been increased by £200 from £3,900; this is £100 above the increase in line with statutory indexation. Taxable income in excess of the lower rate threshold is charged the basic rate of 23%. The upper limit of the basic rate band is increased by £600 to £26,100 - which is line with indexation - for 1997-98. Taxable income in excess of this threshold is charged the higher rate of 40%. The three tax rates and thresholds for 1997-98 are summarised below:

Taxable Income £	Tax Rate
First £4,100	**20%**
£4,101 - £26,100	**23%**
Over £26,100	**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]

[1] HC Deb 25 July 1977 cc 94-95

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. A similar statutory requirement to uprate the lower and the basic thresholds in line with inflation, unless Parliament determines otherwise, is provided under section 1 of *ICTA 1988*. In the case of thresholds, changes must be rounded up to the nearest multiple of £100.

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 1996, the inflation rate was 2.1%.

The ordinary personal allowance is to be increased by £280 for 1997-98, £200 more than the increase under statutory indexation. The age-related personal allowances are to be increased by £200 in excess of statutory indexation as well. The married couple's allowance, and those allowances linked to it, are all to be increased by £40 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 for 1997-98:

Under 65	**£4,045**
65 - 74	**£5,220**
75 and over	**£5,400**

All three allowances are to be increased by an additional £200 on top of the increase under statutory indexation. The basic personal allowance rises by £280; both age related personal allowances rise by £310. The entitlement to age allowance is determined separately for each spouse based on their own age. The extra age allowance is reduced above a certain income limit by £1 for every £2 by which income exceeds the limit (see section **B3**). However no aged 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. A higher 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. Only the basic MCA is transferable between husband and wife; not the higher rates.

The ordinary MCA and the age-related allowances for 1997-98 are set out below:

Both aged under 65	**£1,830**
One or both aged 65 - 74	**£3,185**
One or both aged 75+	**£3,225**

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 highest marginal tax rate. At that time the basic MCA was set at £1,720, and was worth £688 for those whose marginal rate was 40 per cent; whereas it was worth only £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 the current Chancellor, Kenneth Clarke, announced that all three MCAs were to be further restricted to 15 per cent with effect from 1995-96. The 15 per cent restriction will continue to apply to these allowances for 1997-98. As a result, the ordinary MCA will be worth £274.50 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*, Library Research Note 90/9, 5 February 1990.

3. Income Limit for Age Allowance

Taxpayers claiming an age-related allowance whose income exceeds £15,600 for 1997-98 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 the basic MCA. The income limit has been increased in line with inflation, from the limit of £15,200 for 1996-97. 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	**£17,950**
75 and over	**£18,310**

For the MCA, the figures will depend on the age of the husband and of the older spouse. The age-related personal allowance is reduced before the age-related MCA, 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, and for husbands caring for an incapacitated wife. The allowance is equal in value to the ordinary married couple's allowance: £1,830 for 1997-98, 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 (eg, 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 MCA). 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]

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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.

4 Under section 260 of *ICTA 1988*

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 MCA (ie, an allowance of no more than £1,830). 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 MCA: to 20 per cent for 1994-95, and to 15 per cent for 1995-96, 1996-97 and 1997-98.

Under agreements made before 15 March 1988, the taxpayer 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 £1,830 of maintenance paid is restricted to 15 per cent for 1997-98. Those who receive maintenance under the old system receive it gross. Where payments are made direct to an ex-spouse, the first £1,830 may be received tax free (this relief has not been restricted).

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 MCA (ie, £1,830 restricted to 15 per cent for 1997-98). The allowance may be claimed as well as the additional personal allowance, and, of course, the personal allowance. It 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 £1,280 for 1997-98, 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 someone has insufficient income to make use of the allowance, it can be transferred to a spouse. In his 1996 Budget, the Chancellor proposed that the WBA would become subject to the same statutory requirement for indexation as the other income tax allowances.

Summary Table of the Allowances

£	**1992-93**	**1993-94**	**1994-95**	**1995-96**	**1996-97**	**1997-98**
Personal Allowance	3,445	3,445	3,445	3,525	3,765	4,045
" (65 - 74)	4,200	4,200	4,200	4,630	4,910	5,220
" (75 & +)	4,370	4,370	4,370	4,800	5,090	5,400
MCA (basic)	1,720	1,720	1,720*	1,720*	1,790*	1,830*
MCA (65 - 74)	2,465	2,465	2,465*	2,995*	3,115*	3,185*
MCA (75 & +)	2,505	2,505	2,505*	3,035*	3,155*	3,225*
APA	1,720	1,720	1,720*	1,720*	1,790*	1,830*
WBA	1,720	1,720	1,720*	1,720*	1,790*	1,830*
Income Limit	14,200	14,200	14,200	14,600	15,200	15,600
BPA	1,080	1,080	1,080	1,200	1,250	1,280

* Relief restricted to 20 per cent in 1994-95 and 15 per cent in the three tax years: 1995-96, 1996-97, 1997-98.

C. Benefits - Company Cars & Free Fuel

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 tax charge on the benefit of free fuel used in company cars for 1997-98 will increase by 13 per cent for petrol cars, and 15 per cent for 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 for 1997-98 are:

PETROL CARS		DIESEL CARS	
Engine size cc	**Scale charge £**	**Engine size cc**	**Scale charge £**
0 - 1,400	**800**	**0 - 2,000**	**740**
1,400 - 2,000	**1,010**	**2,001 +**	**940**
2,001 +	**1,490**		

D. Pensions

The pension scheme earnings cap will be increased in line with inflation, from £82,200 to £84,000 for 1997-98. 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 remains £1,200 per year, set by the *Finance Act 1996*. 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

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 1997-98.

G. Capital Gains Tax

The annual exempt amount has been increased in line with statutory indexation, to £6,500 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 rate of income.

H. 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 from £200,000 to £215,000 for 1997-98, £10,000 in excess of indexation. This follows a substantial increase of £46,000 last year. Taken together, the threshold has increased by nearly 40 per cent in two years (ie, from £154,000 to £215,000).

I. Profit Related Pay

Profit Related Pay (PRP) is that part of an employee's pay which rises, and falls, in line with the profits of the business in which they work. Provided PRP is paid under a scheme registered with the Inland Revenue, the employee may receive it free of income tax, up to a given limit: either 20% of their salary, or £4,000, whichever is the lower, in the profit period to which the PRP relates. A 'profit period' is the employer's accounting period, normally 12 months. Currently, basic-rate taxpayers receiving PRP will pay up to £960 less income tax (24 per cent of £4,000) than an equivalent employee not receiving PRP. Higher-rate taxpayers pay up to £1,600 per year less income tax.

The Chancellor, Kenneth Clarke, has proposed in his November 1996 Budget that tax relief for PRP be phased out over a three to four year period; so that for profit periods beginning

- before 1 January 1998, there will be no change in the £4,000 ceiling on relief;
- between 1 January 1998 and 31 December 1998, the ceiling will be reduced to £2,000;
- between 1 January 1999 and 31 December 1999, the ceiling will be reduced to £1,000;
- on or after 1 January 2000, no relief will be available.

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