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Personal Tax Allowances & Reliefs 1998-99

This paper sets out the main changes to the personal income tax allowances and reliefs announced in the Budget of 17 March 1998. It lists the principal personal allowances which will be available against tax in the tax year 1998-99, 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.

In his Budget the Chancellor also announced a number of important measures which will not come into effect until the tax year 1999-2000. A short appendix to this paper provides a list of these.

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CONTENTS

A. Rates and thresholds

Income tax is charged at three rates - the lower rate, the basic rate, and the higher rate. All three rates of income tax are unchanged for 1998-99; the lower rate at 20%, the basic rate at 23%, the higher rate at 40%. Taxable income excludes personal allowances, which represent the amount of money someone may receive free of tax.

For 1998-99 the first £4,300 of an individual's taxable income is charged the lower rate. This threshold is increased by £200, in line with inflation. 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 £1,000 to £27,100 for 1998-99, in line with inflation. Taxable income in excess of this threshold is charged the higher rate of 40%. The three tax rates and thresholds for 1998-99 are:

Taxable Income £	Tax Rate
First £4,300	**20%**
£4,301 - £27,100	**23%**
Over £27,100	**40%**

B. Personal allowances

All individuals receive a personal allowance which they can set against 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. There are five other allowances which individuals may be eligible for: the married couple's allowance; the additional personal allowance; tax relief on maintenance payments (sometimes known as the 'maintenance allowance'); the widow's bereavement allowance; and, the blind person's allowance.

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*.[1] 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. 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'. 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.*

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

[1] It is consolidated now in section 257C of the *Income and Corporation Taxes Act (ICTA) 1988.*

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 1997 the inflation rate was 3.6%. All allowances and thresholds for 1998-99 are 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 for tax purposes. Two additional levels of the allowance are provided for the elderly. These three allowances for 1998-99 are:

Under 65	**£4,195**
65 - 74	**£5,410**
75 and over	**£5,600**

All three allowances are increased in line with statutory indexation. The basic personal allowance rises by £150; the two age related allowances rise by £190 and £200 respectively.

The personal allowance is not transferable between spouses. The extra age allowances are reduced above a certain income limit by £1 for every £2 by which income exceeds the limit (see section **B3**). In such cases only the extra allowance is withdrawn; no aged taxpayer receives less than the basic personal allowance available to those under 65.

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. Though a wife has the right to claim half the MCA, couples have to make a joint election if she is to claim the entire allowance. In line with the personal allowance, an age related allowance is given to couples in which at least one partner is over 65 years old, a second if one partner is 75 or over. Only the basic MCA is transferable between husband and wife, not the higher rates. The basic MCA and the two age related allowances for 1998-99 are:

Both aged under 65	**£1,900**
One or both aged 65 - 74	**£3,305**
One or both aged 75+	**£3,345**

The MCA is reduced by one twelfth for each complete tax month pre-marriage. The higher age related allowances are reduced above a certain income limit by £1 for every £2 of excess income, in the same way as personal allowances (see section **B3**).[2]

In the March 1993 Budget it was 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 £1,720 and was worth £688 to 40% taxpayers, whereas it was worth only £344 to 20% 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. The same restriction applied to the allowances tied to the MCA: the additional personal allowance, relief on maintenance payments, and the widow's bereavement allowance (these are discussed below).

The MCA and related allowances were restricted to 15 per cent for 1995-96 and 1997-98. Relief remains restricted to 15 per cent in 1998-99. As a result the basic MCA is worth £285 to all taxpayers. The MCA and related allowances are to be restricted to 10% from 6 April 1999; this cut will *not* take effect until the tax year 1999-2000 (see section **II**).

3. Income limit for age related allowances

Taxpayers claiming an age-related allowance whose income exceeds £16,200 for 1998-99 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 is increased by £600 in line with inflation from the limit of £15,600 for 1997-98. 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	**£18,630**
75 and over	**£19,010**

Only the basic MCA is transferable between husband and wife, not the higher rates. As a consequence, for the MCA the figures will depend on the income of the husband and the age of the older spouse. The age-related personal allowance is reduced before the age related MCA when any individual's tax bill is calculated.[3]

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

4. Additional personal allowance

An additional personal allowance (APA) is available in respect of lone parents caring for children, and for parents whose partner is incapacitated. The allowance is equal in value to the basic married couple's allowance, which is £1,900 for 1998-99 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. Anyone, whether single, divorced or widowed, 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.[4]

In previous years the allowance has been given to a father whose wife was incapacitated, but not to those women with children in this situation. This anomaly is to be abolished, and the allowance is to be extended to women with children and incapacitated husbands living with them. This measure is backdated, so that it has effect from 6 April 1997.

5. 'Maintenance allowance' & 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. This applies to all maintenance payments made under a court order, a Child Support Agency assessment, or other type of legally binding agreement. Provisions in the *Finance Act 1988* removed these transactions from the tax system for agreements made after 15 March 1988.

That said, separated or divorced individuals who pay maintenance direct to their ex-spouse qualify for a limited form of tax relief, equivalent in value to the basic married couple's allowance (which is £1,900 restricted to 15 per cent for 1998-99). Those paying maintenance are not eligible for this 'maintenance allowance' - as it is sometimes known - if the person they make payments to is either a child or someone to whom they have not been married. 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.

People who entered into maintenance arrangements before 15 March 1988 may qualify for tax relief at the level they were allowed in 1988-89. This relief is restricted to 15 per cent on the first £1,900 of the payments they make for 1998-99. Those who receive maintenance under the old system receive it gross. Where payments are made direct to an ex-spouse the first £1,900 may be received tax free (this relief is not restricted).

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4 If they cannot agree, the allowance is split in proportion to the amount of time each spends with the child.

6. Widow's bereavement allowance

The widow's 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 (which is £1,900 restricted to 15 per cent for 1998-99). 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 increased in line with inflation to £1,330 for 1998-99. 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.

Summary table of the allowances

£	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
Personal allowance	3,445	3,445	3,525	3,765	4,045	4,195
" (65 - 74)	4,200	4,200	4,630	4,910	5,220	5,410
" (75 & +)	4,370	4,370	4,800	5,090	5,400	5,600
MCA (basic)	1,720	1,720*	1,720*	1,790*	1,830*	1,900*
MCA (65 - 74)	2,465	2,665*	2,995*	3,115*	3,185*	3,305*
MCA (75 & +)	2,505	2,705*	3,035*	3,155*	3,225*	3,345*
Income limit	14,200	14,200	14,600	15,200	15,600	16,200
APA	1,720	1,720*	1,720*	1,790*	1,830*	1,900*
WBA	1,720	1,720*	1,720*	1,790*	1,830*	1,900*
BPA	1,080	1,080	1,200	1,250	1,280	1,300

* Relief restricted to 20 per cent in 1994-95 and 15 per cent over the four tax years from 1995-96 to 1998-99. It is intended that relief will be restricted to 10 per cent from 1999-2000.

C. 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.[5] Special rules apply in evaluating the cash value of a company car, and free fuel provided for private motoring in a company car. Tax is charged on 35% of the list price of a company car, with discounts for business mileage and older cars. For free fuel, individuals pay a fixed charge dependent on the engine size of the car they use.

It is intended to increase the tax charge on the benefit of free fuel used in company cars by 20 per cent over and above the usual increases in line with pump prices for the next five years. The scale charges on diesel fuel have been increased by more than this margin for 1998-99 to align them with the charges for petrol. The scale charges for 1998-99 are:

PETROL CARS		DIESEL CARS	
Engine size cc	**Scale charge £**	**Engine size cc**	**Scale charge £**
0 - 1,400	**1,010**	**0 - 2,000**	**1,280**
1,400 - 2,000	**1,280**	**2,001 +**	**1,890**
2,001 +	**1,890**		

D. Pensions

The pension scheme earnings cap is increased in line with inflation by £3,600 to £87,600 for 1998-99. 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.

Under the payroll giving scheme an employee can give up to £1,200 per year; this sum 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

[5] The cash value is added to their taxable income, and taxed accordingly; ie, taxed at the same rate as the rest of their income (ie, 23% 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.

minimum limit was £600; the current minimum is £250. In his 1998 Budget the Chancellor announced that under a new scheme to be introduced later this year - Millennium Gift Aid - the minimum limit would be cut to £100 for donations to education and anti-poverty projects in the world's poorest countries.

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 is cut to 10 per cent from 6 April 1998. This reduction was announced at the time of the July 1997 Budget.[6]

G. Capital gains tax

The annual exempt amount has been increased in line with statutory indexation to £6,800 for 1998-99. Individuals may realise gains up to this threshold free of tax. Above this limit gains are taxed at one's marginal rate of income. In his 1998 Budget the Chancellor announced a major reform in the structure of capital gains tax. In brief, indexation will be frozen on 6 April 1998. It is to be replaced with a taper. For assets sold after this date indexation will be computed from the date of the asset's acquisition to April 1998. For assets acquired on or after 1 April 1998 no indexation allowance will be given. The tax rate will be tapered depending on the amount of time the investment has been held from 6 April 1998 to the date on which it is sold. The taper will be more generous for business assets.

H. 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 per cent above the tax-free threshold. The threshold is increased in line with inflation by £8,000 to £223,000 for 1998-99.

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6 This provision is set out in section 15 of the *Finance (No.2) Act 1997*.

Appendix: Measures to be introduced after 1998-99

Three important tax measures were announced in the 1998 Budget which will be introduced after the tax year 1998-99.

I. Married couple's allowance & related allowances

The married couple's allowance and the allowances tied to it - the additional personal allowance, the widow's bereavement allowance, and relief for maintenance payments to a divorced or separated spouse - are set at £1,900 restricted to 15 per cent for 1998-99. These allowances are to be restricted to 10 per cent from 6 April 1999. Couples who receive either of the two age related married couple's allowances will be compensated for this change with a corresponding increase in their allowance above indexation.

J. Individual Savings Accounts

The Individual Savings Account (ISA) is a new type of tax-favoured savings vehicle which will be introduced in April 1999, to replace the two existing schemes which provide tax relief for different forms of saving: Tax-exempt Special Savings Accounts (TESSAs) for longer term cash savings; and Personal Equity Plans (PEPs) for stocks and shares. In December 1997 the Government published a consultation document on ISAs, and the main features of the ISA reflect the comments this document elicited:

- everyone will be able to subscribe to the new savings account whether or not they already hold PEPs and/or TESSAs;

- the new account will start on 6 April 1999 and be guaranteed to run for at least ten years;

- individuals may subscribe up to £5,000 a year in an ISA, of which no more than £1,000 can be held in cash and £1,000 in life insurance;

- however, in the first year of the scheme only (1999-2000), the annual limit will be £7,000 of which no more than £3,000 can be cash and £1,000 life insurance;

- the account will be completely free of tax, and there will be no statutory time limit for holding savings in an account or a minimum subscription;

- subscriptions to PEPs can be made until 5 April 1999, and all PEPs held at 5 April 1999 can continue to be held as PEPs outside the new savings account, but with the same tax advantages as the new account;

- savers will be able to open TESSAs until 5 April 1999 and pay into them under existing rules for their full 5 year life; capital from maturing TESSAs can be transferred into the cash component of the new savings account;

- neither annual subscriptions to TESSAs nor any maturing capital will count against the annual subscription limit for the new account.

K. Working Families Tax Credit

The Working Families Tax Credit (WFTC) is a payable tax credit assessed and administered by the Inland Revenue to be introduced from October 1999 replacing the social security benefit Family Credit. It will be payable through the wage packet from April 2000. The essential requirement is for the family to have children, and for at least one of the parents to work 16 or more hours a week. The maximum amount of WFTC anyone will be entitled to is the sum of several elements: the basic tax credit, a tax credit for each child in the family (with higher rates paid for older children), an extra credit where the main earner works for more than 30 hours a week; and a credit to help meet the costs of childcare. The full WFTC is payable if a family's net income (excluding the WFTC and Child Benefit) is less than £90 a week. Above this threshold, WFTC is reduced by 55p for every extra £1 of net income.

The WFTC contains the following elements:

		(£ per week, 1998-99 prices)
Basic tax credit (one per family)		48.80
Tax credits for each child aged	0-11	14.85
	11-16	20.45
	16-18	25.40
Extra tax credit for working 30 hours or more a week		10.80

A childcare tax credit, within the WFTC, which will be worth 70 per cent of eligible childcare costs (typically, registered costs, up to a maximum of £100 a week childcare costs for families with one child and £150 of costs for families with two or more children).