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Direct taxes: rates & allowances 1999-2000

This paper sets out the main changes to direct tax rates and allowances announced in the Budget of 9 March 1999. It lists the principal personal allowances which will be available against income tax in the tax year 1999-2000, 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, nor to the Working Families Tax Credit (which is to replace Family Credit from October 1999).

In his Budget the Chancellor also announced a number of important measures which will not come into effect until the tax year 2000-01 or later. A short appendix to this paper provides a list of these.

Antony Seely

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Summary of main points

- Income tax is charged at three rates. For 1999-2000 the basic rate of 23% and the higher rate of 40% are unchanged. The lower rate of 20% is to be replaced, with a new starting rate of tax of 10%, to be charged on the first £1,500 of taxable income. The basic rate is charged on income in excess of this limit, up to the basic rate threshold of £28,000.

- The basic rate of income tax is to be cut from 23% to 22% from 6 April 2000. This will apply from the tax year 2000-2001.

- The personal allowance will be increased in line with inflation to £4,335. Personal allowances for older people will be increased by up to £200 more than statutory indexation - to £5,720 and £5,980 respectively for people aged 65-74 years and 75 years and over. The income limit for the age-related allowances will be increased in line with statutory indexation to £16,800.

- The married couple's allowance (MCA) and related allowances will rise in line with indexation to £1,970 for 1999-2000, though they are to be restricted to 10 per cent, down from 15 per cent. Couples in which at least one of the spouses is over 65 are eligible for an age-related married couple's allowance; a larger allowance is given if at least one spouse is 75 or over. These age-related allowances have been increased to ensure that the value of this allowance is maintained for taxpayers, despite being restricted to 10 per cent for 1999-2000.

- The MCA, and a number of associated allowances, are to be abolished from 6 April 2000. However, those couples who are claiming either of the age-related MCAs at this time will be able keep the MCA when it is abolished for younger couples.

- Tax relief on loans qualifying for interest relief for the purchase of a main residence (MIRAS) is unchanged for 1999-2000. There remains a £30,000 limit on loans, and relief is restricted to 10 per cent. However, MIRAS is to be withdrawn from 6 April 2000.

- A new children's tax credit will be introduced from April 2001. Families who have one or more children under 16 living with them will be eligible to claim this credit.

- This paper does not provide details of the cash benefits provided under the social security system, nor does it examine the Working Families Tax Credit, and Disabled Person's Tax Credit - two new tax credits which are to replace the in-work benefits Family Credit and Disability Working Allowance from October 1999. Details on the latter are provided in Library Research paper 99/3, *Tax Credits Bill*, 18 January 1999.

CONTENTS

I Rates and thresholds

A. Income tax

Income tax is charged at three rates - the lower rate, the basic rate, and the higher rate. The basic rate and the higher rate are both unchanged for 1999-2000: at 23% and 40% respectively. The lower rate of 20% has been replaced with a new starting rate of 10%. Taxable income excludes personal allowances, which represent the amount of money someone may receive free of tax.

The new 10% starting rate will apply to taxable income up to £1,500 for 1999-2000. In the previous tax year the 20% rate applied to taxable income up to £4,300. 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 £900 to £28,000 for 1999-2000, 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 1999-2000 are:

Taxable Income £	Tax Rate
First £1,500	**10%**
£1,501 - £28,000	**23%**
Over £28,000	**40%**

The basic rate of tax is to be cut from 23% to 22% from April 2000; it will not take effect *until* the tax year 2000-2001 (for details see the appendix to this paper).

The rates of income tax on savings income - other than dividend income - are unchanged for 1999-2000: the lower rate of 20% for income below the basic rate limit, and the higher rate of 40% above that. The rates of tax on dividend income are 10% for income below the basic rate limit, and 32.5% above that.

B. National Insurance contributions

Employees are charged National Insurance contributions (NICs) on their earnings, at a rate of 10%, if their earnings exceed the lower earnings limit (LEL). For 1999-2000 the LEL is £66 per week. NICs are subject to a cap at the upper earnings limit (UEL), which is £500 per week for 1999-2000. Employees contracted out of the state earnings related pension scheme (SERPS) pay a reduced rate of NICs.

Employers pay NICs on employee earnings at a rate of 12.2%, on earnings above the LEL. National insurance contribution rates for 1999-2000 are set out below:

Total weekly earnings	Employee NICs standard rate	Employee NICs contracted-out rate[1]
Below £66 (LEL)	0	0
Above £66	10% of earnings between £66 and £500	8.4% of earnings between £66 and £500

Total weekly earnings	Employer NICs standard rate	Employer NICs contracted-out rate[1]
Below £66 (LEL)	0	0
£66 to £83	0	0
£83 to £500	12·2%	9·2%
Above £500	12·2%	9·2% of earnings between £83 and £500, 12·2% of earnings above £500

[1] Employees contracted out of SERPS pay lower contributions. The "contracted-out rebate" is currently fixed at 4·6 per cent of earnings between the employee LEL and the UEL. 1·6 per cent is deducted from employees' contributions and 3% from employers' contributions. An employer rebate of 3% is paid in respect of the earning between £66 and £83 though employers pay no NICs in respect of these earnings. Slightly different rebate arrangements apply for employees who contract out into a money-purchase scheme.

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. 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

[1] Consolidated in section 257C of the *Income and Corporation Taxes Act (ICTA) 1988*

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 basic rate 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 rounded up to the nearest multiple of £100.[2] 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 1998 the inflation rate was 3.2%.

A. 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 1999-2000 are:

Under 65	**£4,335**
65 - 74	**£5,720**
75 and over	**£5,980**

The personal allowance is increased by £140, in line with inflation. The two age-related allowances are increased by £310 and £380 respectively. These increases are well in excess of statutory indexation, which would have limited this increase to £180.

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 Part II C of this paper). In such cases only the extra allowance is withdrawn; no pensioner receives less than the basic personal allowance available to those under 65.

B. 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

2 The provisions for statutory indexation are to be revised under proposals to be set out in the Finance Bill 1999 (*Financial Statement & Budget Report* HC 298 March 1999 p 99).

second if one partner is 75 or over. Only the basic MCA is transferable between husband and wife, not the higher rates. 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 Part II C of this paper).

For 1999-2000 the basic MCA and the two age-related allowances are:

Both aged under 65	**£1,970**
One or both aged 65 - 74	**£5,125**
One or both aged 75+	**£5,195**

Tax relief for these allowances is restricted to 10%.

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 the four tax years from 1995-96 to 1998-99.

In his March 1998 Budget the Chancellor announced that the MCA and related allowances would be restricted to 10% from 6 April 1999, but that this change "would not affect elderly taxpayers, whose extra allowances will be protected."[3] As a consequence each of the age-related MCAs are increased to ensure that the value of the allowance to taxpayers is maintained, even though it is restricted to 10% and not 15%, as well as being increased in line with inflation. For its part, the basic MCA is increased by £70, in line with inflation.

The MCA, and a number of associated allowances, are to be abolished from *April 2000*. However, those couples who are claiming either of the age-related MCAs at this time will be able keep the MCA when it is abolished for younger couples. Details are given in the appendix to this paper.

[3] HC Deb 17 March 1998 c 1108

C. Income limit for age related allowances

Taxpayers claiming an age-related allowance whose income exceeds £16,800 for 1999-2000 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 £16,200 for 1998-99. For individual taxpayers qualifying for an age-related personal allowance the benefit of the allowance will not fall out until the following levels of total income:

65 - 74	**£19,570**
75 and over	**£20,090**

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.[4]

D. 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.[5] The allowance is equal in value to the basic married couple's allowance, which is £1,970 for 1999-2000 restricted to 10 per cent. The allowance is to be abolished from *April 2000* (see the appendix to this paper).

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.[6]

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

5 In previous years the allowance had only been given to a father whose wife was incapacitated, but not to those women with children in this situation. In the March 1998 Budget this anomaly was abolished, and the allowance was extended to women with children and incapacitated husbands living with them, backdated to have effect from 6 April 1997.

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

E. '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 £1,970 restricted to 10 per cent for 1999-2000). 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. This allowance is to be abolished from *April 2000* (see appendix for details).

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 10 per cent on the first £1,970 of the payments they make for 1999-2000. Those who receive maintenance under the old system receive it gross. Where payments are made direct to an ex-spouse the first £1,970 may be received tax free (this relief is not restricted).

F. 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 £1,970 restricted to 10 per cent for 1999-2000). 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.

The allowance is to be abolished from *April 2000* (see the appendix to this paper).

G. 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 £1,380 for 1999-2000. 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

£	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00
Personal allowance	3,445	3,525	3,765	4,045	4,195	4,335
" (65 - 74)	4,200	4,630	4,910	5,220	5,410	5,720
" (75 & +)	4,370	4,800	5,090	5,400	5,600	5,980
MCA (basic)	1,720*	1,720*	1,790*	1,830*	1,900*	1,970*
MCA (65 - 74)	2,665*	2,995*	3,115*	3,185*	3,305*	5,125*
MCA (75 & +)	2,705*	3,035*	3,155*	3,225*	3,345*	5,195*
Income limit	14,200	14,600	15,200	15,600	16,200	16,800
APA	1,720*	1,720*	1,790*	1,830*	1,900*	1,970*
WBA	1,720*	1,720*	1,790*	1,830*	1,900*	1,970*
BPA	1,080	1,200	1,250	1,280	1,300	1,380

* Relief restricted to 20 per cent in 1994-95, 15 per cent over the four tax years 1995-96 to 1998-99, and to 10 per cent for 1999-2000.

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.[7] 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. These discounts are being cut in value for 1999-2000, to pave the way for a wider reform in the company car tax regime which is to come into operation from *April 2002.* The new system will charge tax on a percentage of the car's price, graduated according to the level of carbon dioxide emissions.

For free fuel, individuals pay a fixed charge dependent on the engine size of the car they use. In the March 1998 Budget it was announced that this charge would be increased by 20 per cent over and above the usual increases in line with pump prices for the following five years. The scale charges for free fuel for 1999-2000 are given below:

[7] 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.

PETROL CARS		DIESEL CARS	
Engine size cc	**Scale charge £**	**Engine size cc**	**Scale charge £**
0 - 1,400	**1,210**	**0 - 2,000**	**1,540**
1,400 - 2,000	**1,540**	**2,001 +**	**2,270**
2,001 +	**2,270**		

IV Pensions

The pension scheme earnings cap is increased in line with inflation by £3,000 to £90,600 for 1999-2000. This is the maximum earnings from which contributions to a personal or occupational pension scheme can attract tax relief.

V 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 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 minimum limit was £600; the current minimum is £250. Millennium Gift Aid - introduced in 1998 - provides tax relief on cash gifts of at least £100 for donations to education and anti-poverty projects in the world's poorest countries. The amount of £100 may be made up by instalments, but must be paid before 31 December 2000.

VI Mortgages

Tax relief on loans qualifying for interest relief for the purchase of a main residence (MIRAS) is unchanged for 1999-2000. There remains a £30,000 limit on loans, and relief is restricted to 10 per cent. MIRAS was limited to the basic rate of income tax from 6 April 1991, and has been further restricted since then: to 20 per cent from 6 April 1994, to 15 per cent from 6 April 1995, and to 10 per cent from 6 April 1998. However, MIRAS is to be withdrawn from *April 2000*.

VII Capital gains tax

Capital gains tax is charged on gains in excess of the annual exempt amount, which is increased in line with statutory indexation to £7,100 for 1999-2000. Individuals may realise gains up to this threshold free of tax. Capital gains are treated as the top slice of income, and have been taxed at the appropriate income tax rates of 20%, 23% or 40%, depending on the level of total income and gains. From 1999-2000 capital gains tax rates will be aligned with those for savings income so that gains are charged at 20% where the gains when added to total income are below the basic rate limit, and 40% where they exceed that limit.

VIII 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 £231,000 for 1999-2000.

Appendix: Measures to be introduced after 1999-2000

Several important measures were announced in the March 1999 Budget, but will not take effect in the coming tax year. They include the following:

Tax year 2000-2001

The basic rate of income tax is to be cut from 23% to 22% from 6 April 2000.

The married couple's allowance (MCA) for a husband and wife aged under 65 will be removed from 6 April 2000. Two other personal allowances linked with the MCA will be abolished at this time: the additional personal allowance, and the widow's bereavement allowance. Couples in which at least one of the spouses is aged 65 or more on or before 5 April 2000 will be able to keep the MCA when it is abolished for younger couples. After that date, people will not be able to make new claims for the MCA when they or their spouse reach the age of 65. However, when a person born on or before 5 April 1935 newly gets married, they or their spouse will still be eligible to claim MCA.

Tax relief for maintenance payments will cease for payments made and falling due on or after 6 April 2000. Tax relief for maintenance payments will be retained where one or more of the parties is aged 65 or over on 5 April 2000. In addition, the special transitional relief for payments under arrangements originally set up before 15 March 1988 is to be withdrawn at this time. Instead, the relief for payments under maintenance arrangements set up on or after 15 March 1988 will apply to all maintenance payments for those who remain entitled to relief. Recipients of payments made under arrangements set up before 15 March 1988 will no longer be taxable on the payments they receive.

Tax relief on loans qualifying for interest relief for the purchase of a main residence (MIRAS) will be withdrawn from 6 April 2000.

Tax year 2001-2002

A new children's tax credit will be introduced from April 2001. Families who have one or more children under 16 living with them will be eligible to claim this credit. It will take the form of an allowance for which relief is given at 10 per cent. In 2001-02, the amount will be £4,160 at 10 per cent. The children's tax credit will be tapered, so that it is gradually withdrawn where the person claiming it is liable to tax at the higher rate. These people will lose £1 of tax credit for every £15 of income above the point at which they start to pay higher rate tax until their entitlement to the credit is exhausted (at an income of about £38,500).