

Emergency budget update

A guide outlining how it affects contractors

The Chancellor has positioned Tuesday's budget as a five-year plan to rebuild the British economy based on the Government's values of responsibility, freedom and fairness. It is certainly a budget that shows the Government's commitment to small businesses with good news in relation to Corporation Tax rates and NI thresholds which will be a relief to a lot of freelancers. Even the bad news of an increase in the VAT is tempered by the changes in flat rates for small business. Whilst we often worry about the devil being in the detail there is an awful lot of detail in this budget.

Tax Changes

VAT: From January 4 2011, the main rate of VAT will rise from 17.5% to 20%. Current zero-rated items like children's clothes and magazines will remain exempt. Rates under the flat rate scheme for small businesses will also be increased. From an initial review of the new flat rates this should have a positive impact on the take home pay of many contractors.

NI: Employer's and Employee's NI rises announced by the last Government will go ahead as planned from April 2011 which is bad news for employees generally and therefore for umbrella customers. The Chancellor has announced that in order to limit the most damaging part of the planned increase in Employer's NI he will raise by £21 the threshold before which NI is charged.

PAYE: Income tax rates will remain unchanged including the 50p rate of income tax which took effect from April 2010. The personal allowance for under 65's will however be increased by £1,000 to £7,475 in April 2011. As a result, the Government estimates that the 880,000 lowest income taxpayers will be removed from tax altogether, and 23 million tax payers will benefit by up to £170 per year.

Corporation Tax: Corporation Tax will be cut next year to 27%, and by 1% annually for the next three years, until it reaches 24%. The small companies' tax rate will be cut to 20%. This is good news for those operating through PSCs.

The government will help low-spending councils in England to freeze council tax for one year from April 2011.

Capital Gains Tax: Capital Gains Tax remains at 18% for low and middle-income savers but from midnight, higher rate taxpayers will pay 28%.

IR35: The Government remains committed to a review of IR35 and small business tax and will release further details shortly.

UK Economy

The economy is predicted to grow by 1.2% this year, 2.3% next year, 2.8% in 2012, 2.9% in 2013 and 2.7% in both 2014 and in 2015.

Consumer price inflation is expected to reach 2.7% by the end of 2010 before "returning to target in the medium term". The inflation target remains at 2%, as measured by the Consumer Prices Index.

Unemployment is forecast to peak this year at 8.1% and then fall for each of the next four years, to reach 6.1% in 2015.

Borrowing

The structural current deficit "should be in balance" by 2015-16.

The balance of spending cuts vs tax rises would be 77% to 23%.

The measures are forecast to result in public sector net borrowing of £149bn this year, £116bn next year, £89bn in 2012-13 and £60bn in 2013-14. Mr Osborne said by 2014-15 borrowing would reach £37bn, falling to £20bn in 2015-16.

Spending

The Chancellor said the state now accounted for "almost half" of all national income which was "completely unsustainable".

He said current expenditure would rise from £637bn in 2010-11 to £711bn in 2015-16, blaming a "rapidly rising bill for debt interest".

He said his Budget implied further £17bn cuts in departmental spending by 2014/15. Unprotected departments face an average real cut of around 25% over four years.

He said that compared with the plans set out by Labour, the government would cut additional current expenditure by £30bn a year by 2014-15.

There would be no further reductions in capital spending totals in this Budget but "careful choices" would be made about how it was spent. Projects with "a significant economic return to the country" would be prioritised – to be assessed in the autumn spending review.

Public Sector Pay

Public sector workers face a two-year pay freeze, although 1.7 million of those earning less than £21,000 will get a flat pay-rise worth £250 in both years.

Pensions

George Osborne announced that he was rethinking Labour proposals, which would have gradually withdrawn this relief on those earning more than £130,000 a year. The changes were due to come into effect from April next year. But the Government will now consult with employers and insurers on whether it would be better to reduce the annual amount people can save into a pension instead – which may raise a similar amount for the Treasury, but be simpler to administer and put in place. Provisional analysis has suggested that reducing the annual allowance from £255,000 a year to between £30,000 and £45,000 would produce a similar amount – an estimated £3.5bn.

Surprisingly the Chancellor promised to increase the state pension in April 2011 by at least the equivalent of RPI.

Benefits

Child benefit will be frozen for the next three years.

Tax credits will be reduced for families earning over £40,000 next year.

From 2011 - except for the state pension and pension credit - benefits, tax credits and public service pensions will rise in line with the Consumer Price Index, rather than the, generally higher, Retail Price Index, saving over £6 billion a year by the end of the Parliament.

Housing Benefit will be reformed so there is a maximum limit of £400 a week, to save £1.8bn a year by the end of the Parliament.

The government will introduce a medical assessment for Disability Living Allowance from 2013 for new and existing claimants.

Cigarettes, Alcohol and Fuel

There is no proposed change this time round.

Council tax

These will be frozen in 2011-2012.

Summary

This is probably as good a budget as small business and freelancers could have hoped for.

The negatives are:

- VAT increase will increase the burden on consumers and potentially restrict growth
- The rise in Employer's NI has been retained, albeit with an increased threshold to reduce the overall burden

The positives are:

- Corporation rates are to be reduced
- Income tax remains unchanged

Further details will emerge over the next few weeks and we will update the site as and when anything likely to impact our customers arises.