



FEATURE ARTICLE

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The Budget - The Devil is in the Detail.....

To be frank George Osborne's second Budget was never going to be easy. Inflation is at its highest level for 20 years, if the latest growth figures are anything to go by the 'green shoots of recovery' are not really sprouting and with our national debt still at record levels there was little, if any, money in the coffers, leaving him little room for manoeuvre. The concern before the Budget was that he might increase the tax burden and of course he didn't – or did he?

Of particular note for many journalists were announcements that from April 2012 the tax-free personal allowance will rise £630 to £8,015 and that the Treasury will consider ways to simplify our overly complicated tax system by commissioning a consultation on merging national insurance and income tax. Osborne's surprise final flourish, which almost seems obligatory in Budget speeches in the modern era, was abolishing April's fuel duty increase, and cutting fuel duty by 1p per litre.

One particular announcement which for many may have gone "under the radar" was that various tax allowances, which include the ISA limit, the capital gains tax allowance and the starting level for paying NI, (but not income taxes) will from April 2012 be linked to the Consumer Price Index (CPI) rather than Retail Price Index (RPI).

This is important because statisticians use two main measures to calculate inflation – the retail prices index and the consumer prices index. Both track the changing cost of a basket of goods and services, from food to travel fares, over the course of a year. The key difference between them is that RPI includes housing costs such as council tax and mortgage repayments. This means that CPI is typically lower than RPI in the figures that are produced monthly by the Office for National Statistics. Indeed the latest numbers that I have at the time of writing this article are those for February which show CPI at 4.4 per cent and RPI at 5.5 per cent.

RPI, which started in 1947, has historically been the favoured measure of inflation used by governments when calculating increases in pensions and various benefits each year. However, since its first "emergency" budget in June 2010 the Coalition Government has been introducing CPI as its



favoured inflation measure. It claims CPI, which the Bank of England uses for its inflation target, better reflects the costs incurred by the typical household.

To highlight the effect of a change from RPI to CPI we only have to look at the projected effect on National Insurance revenues as estimated by the Treasury themselves. The fact is that the Treasury has estimated that it will receive almost £2billion in extra National Insurance by April 2016 as a result of the switch away from the Retail Prices Index.

As I have already said CPI inflation is currently 4.4 per cent while RPI is 5.5 per cent and these are expected to fall to 2.5 per cent and 3.6 per cent from next year. But the difference between the two measures is expected to increase as interest rates rise. By 2015 RPI is forecast to be at 3.8 per cent which is forecast to be almost double the CPI rate of 2 per cent.

To be frank switching from RPI to CPI is simply a clandestine way of increasing the tax take.

I would also in this short article like to consider the proposal of merging income tax and National Insurance, which at first mention of course seems eminently sensible. Thinking about this a little more however we would of course need separate tax rates for pensioners, who do not have to pay NI. (Without this, some would see their tax bills rise by 60% as the basic rate of tax went up from 20% to 32%.) In addition, based on the current tax system you would also need separate rates for savings and dividend income. All of this means that to maintain the tax take at its current level we could in theory end up with ten different income tax rates:

- 0% for the first part of income.
- 10% for savings interest — but only for those on low incomes.
- 20% for pensioners and savings income for those below pension age (whatever age that may be?)
- 32% basic rate on earned income for those below pension age.
- 32.5% on share dividends for higher-rate taxpayers.
- 40% for pensioners at the higher rate and savings income for those below pension age.
- 42% higher rate on earned income for those below pension age.
- 42.5% on dividends for top-rate payers.
- 50% for the wealthiest pensioners and savings income for top earners.
- 52% on earned income over £150,000 a year for those below pensionable age.

This is without including the marginal rate of 30% faced by pensioners with incomes above the income limit for age related allowances as their higher personal allowances are withdrawn and the 60% marginal rate faced by those earning over £100,000 as their personal allowance is withdrawn.

There are then questions such as what rate would be given in terms of pension tax relief?

All in all I am for simplification, in fact I have never met anybody who is against it, but my concern is that simplification could ultimately mean consolidation/higher taxes?



So what is my conclusion from Mr Osborne's second Budget? That sensible financial planning such as that provided by Lighthouse advisers has never been more valuable than it is now.

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