Chartered Accountants & Registered Auditors

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SPENDING REVIEW 2010

Introduction

The Comprehensive Spending Review (CSR) announcement was effectively the second stage of the June Emergency Budget. Budgets traditionally attract more attention, but in this instance the CSR is the more significant element. The context is that total Government expenditure in the current year is estimated to be £697 billion and Government receipts will be only £548 billion, leaving an expected shortfall of £149 billion.

The goal the Chancellor set in the Budget was to bring public sector net borrowing down from 11% of gross domestic product in 2009/10 to near break-even by 2015/16. Just over three-quarters of that reduction – £99 billion in 2015/16 – has been earmarked to come from spending cuts. The balance is to be derived from higher taxation, such as next year's VAT and NIC increases.

The Chancellor announced cumulative cuts to Government departments of just under 20% a year by 2015/16, with a total reduction in the public sector headcount expected to be 490,000 by then. Some areas of expenditure were protected in varying degrees, notably: schools, science, overseas aid, the National Health Service and defence. The main target of savings is the welfare budget, where the annual savings are expected to be about £7 billion (including tax credit changes) by 2014/15, in addition to the £11 billion a year by 2014/15 announced in the June Budget.

"We are going to ensure that we do not saddle our children with the interest on the interest on the interest of the debts we were not ourselves prepared to pay."

George Osborne

Key changes

The key changes include:

- A cap on total benefit income that a household can receive from 2013/14, with a few exceptions.
- A one-year time-limit on contributory Employment and Support Allowance (ESA) for those in the Work Related Activity Group from 2012/13.
- The removal of Disability Living Allowance Mobility Component from care home residents from October 2012.
- Confirmation that the formerly temporary increase in Cold Weather Payments to £25 will become permanent from 2011/12.
- A one-year extension of the temporary rule changes to Support for Mortgage Interest to January 2012. This maintains the reduced waiting period and the £200,000 mortgage limit.
- The withdrawal of Child Benefit from higher rate taxpayer families from January 2013, as announced.
- A range of further reforms to the Child and Working Tax Credits from 2011/12.
- The use of real time PAYE information for calculating tax credits.

CONTENTS

- An increase in public service pension employee contributions from 2012/13.
- A speeding up of the increase in the state pension age, so that it will become 66 for both men and women in April 2020.
- A four-year freeze on Savings Credit in Pension Credit from 2011/12.

In addition, there was indirect confirmation that the National Employment Savings Trust (NEST) pension scheme will go ahead from 2012 as expected. The Government also confirmed that Equitable Life policyholders who suffered losses will receive total compensation of £1.5 billion.

WELFARE BENEFITS

The Chancellor announced (or re-announced) a range of changes under the general heading of welfare reform. These will provide annual savings of nearly £6 billion by 2014/15. The main features are:

Employment and Support Allowance (ESA)

ESA will be subject to a new restriction. ESA is a benefit for those who are unable to work because of disability or ill-health. Contributory ESA will be limited to one year for those in the Work Related Activity Group (broadly those who are assessed as able to work). This effectively prevents long-term payments to any claimant. The move comes at a time when Incapacity Benefit claimants are being moved over to ESA and is projected to yield savings of £2 billion a year by 2014/15.

"We are all in this together and all must make a contribution."

George Osborne

Disability Living Allowance

The mobility component of Disability Living Allowance for people in residential care will be removed, where such costs are already met from public funds. This should save £135 million a year by 2014/15.

Support for Mortgage Interest (SMI)

The additional assistance for homeowners in financial difficulty introduced by the previous Government will be extended by one year beyond its originally planned expiry date of January 2011. The waiting period for new working SMI claimants will therefore remain at 13 weeks and the limit on the amount of mortgage covered by SMI will stay at £200,000.

Child benefit

As recently announced, child benefit will be withdrawn from families with a higher rate taxpayer. This will take effect from January 2013 and is now projected to produce a saving of £2.5 billion a year by 2014/15. This figure is more than double the original estimate.

Capped benefits

Also as announced earlier, total household benefit payments will be capped from 2013 at around £500 a week for couples and lone parent households, and at around £350 a week for single adult households. As the Chancellor said, the aim is that: "No family that doesn't work will receive more in benefits than the average family that does go out to work." All Disability Living Allowance and War Widow Pension claimants are exempted from the cap.

TAX CREDITS

The June 2010 Budget set out a raft of future changes to the tax credit rules, including significantly reduced income thresholds for entitlement to the family element of the Child Tax Credit. Further changes to tax credits have now been announced, saving over £1.1 billion by 2014/15.

Childcare costs

The proportion of childcare costs that parents can claim through the childcare element of the Working Tax Credit will be cut from 80% to 70% from April 2011. At current rates, this represents a reduction of up to £30 a week.

Working hours eligibility

The eligibility rules will be revised. Couples with children will have to work for at least 24 hours a week between them, with one partner working at least 16 hours a week, in order to qualify for the Working Tax Credit.

"A fair government makes sure that those with the broadest shoulders bear the greatest burden."

George Osborne

Working Tax Credit (WTC)

The basic and 30 hour elements of WTC will be frozen for three years from 2011/12. The basic element is £1,920 and the 30-hour element is £790 in 2010/11.

Child element

The child element of Child Tax Credit (£2,300 in 2010/11) will receive an above-indexation increase of a further £30 in 2011/12 and £50 in 2012/13. This will be in addition to the £150 and £60 increases announced in the June Budget.

PENSIONS

The June 2010 Budget contained several surprise announcements on the pensions front. On this occasion Mr Osborne has again managed to produce some pension news that was not widely expected.

State Pension Age (SPA)

The SPA will increase to age 66 for both men and women from April 2020. Under current legislation, the SPA is due to be increased to 66 between 2024 and 2026. For men, the new SPA will be phased in from December 2018 to April 2020. For women, whose SPA is already in the process of being raised to 65 by April 2020, there will be a two-stage process:

- From April 2016 to December 2018, the pace of phasing in the increase will be accelerated to three months in every four so that by November 2018 women's SPA will be 65 (the same as for men).
- From December 2018 to April 2020, the rate of phasing in will be the same as for men.

Savings credit

The savings credit element of Pension Credit (worth up to £20.52 a week for a single person and £27.09 for a couple in 2010/11) will be frozen in cash terms for four years starting in April 2011. This will save £330 million a year by 2014/15.

"Our aim will be to extract the maximum sustainable tax revenues from financial services."

George Osborne

National Employment Savings Trust (NEST) and auto-enrolment

The financial settlement for the Department for Work and Pensions includes funding for the introduction of auto-enrolment in employee pension arrangements from 2012 and the establishment of the NEST.

Public service pensions

From 2012/13, there will be an increase in employee contribution rates for members of unfunded public service pension schemes and the Local Government Pension Scheme. However, an exception will be made for the Armed Forces Pension Scheme. Full details will be announced in the 2011 Budget. The projected overall savings will be about £1.75 billion in 2014/15.

The Chancellor said that he anticipated that one of the smallest and most controversial public service schemes, the parliamentary pension scheme, "will have to end".

HM REVENUE & CUSTOMS (HMRC)

HMRC have not escaped the spending cuts and they are expected to achieve 'overall resource savings' of around 15% by 2014/15. However, the HMRC settlement includes:

- £900 million of investment to "address the tax gap and tackle avoidance and evasion". The expenditure is expected to bring in an additional £7 billion a year in tax revenues by 2014/15.
- £100 million to improve the operation of Pay As You Earn (PAYE).
- Measures to use real time PAYE information in tax credit calculations, reducing the need for claimants to inform HMRC of any changes and limiting scope for overpayments.

BANKS

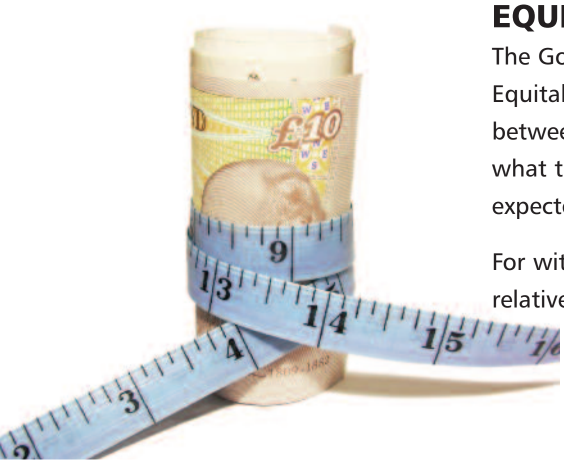
The Government announced a bank levy in the June Budget as an additional and permanent tax on the industry. Draft legislation will be published on 21 October. The levy is expected to generate around £2.5 billion a year.

HMRC is to work with the banking sector to secure their adoption and implementation of the Code of Practice on Taxation by the end of November. Currently, only four out of fifteen leading banks have signed up. The code, announced by the previous Chancellor, requires that banks should comply with both the letter and the spirit of the law and must not engage in or promote tax avoidance.

EQUITABLE LIFE POLICYHOLDERS

The Government has decided to adopt the 'relative loss' basis for compensating Equitable Life policyholders. This provides compensation based on the difference between what policyholders actually received from their Equitable Life policies, and what they would have received if they had invested elsewhere. The cost of this is expected to be 'in the region of £1.5 billion'.

For with profits annuity policyholders, the Government will cover the cost of the total relative loss suffered, which is estimated at £620 million. These policyholders will receive their compensation in the form of regular payments, rather than as a lump sum.



DEPARTMENT PROGRAMME AND ADMINISTRATION BUDGETS

	Baseline 2010/11 £ billion	Plan 2014/15 £ billion	Cumulative real change %
Education	50.8	53.9	-3.4
NHS (Health)	98.7	109.8	1.3
Transport	5.1	4.4	-21
CLG Communities	2.2	1.2	-51
CLG Local Government 5	28.5	22.9	-27
Business, Innovation and Skills	16.7	13.7	-25
Home Office	9.3	7.8	-23
Justice	8.3	7.0	-23
Law Officers' Departments	0.7	0.6	-24
Defence	24.3	24.7	-7.5
Foreign and Commonwealth Office	1.4	1.2	-24
International Development	6.3	9.4	37
Energy and Climate Change	1.2	1.0	-18
Environment, Food and Rural Affairs	2.3	1.8	-29
Culture, Media and Sport	1.4	1.1	-24
Work and Pensions	6.8	7.6	2.3
Scotland	24.8	25.4	-6.8
Wales	13.3	13.5	-7.5
Northern Ireland	9.3	9.5	-6.9
HM Revenue & Customs	3.5	3.2	-15
HM Treasury	0.2	0.1	-33
Cabinet Office	0.3	0.4	28
Single Intelligence Account 11	1.7	1.8	-7.3
Small and Independent Bodies	1.8	1.4	-27
Reserve	2.0	2.5	-
Special Reserve	3.4	2.8	-
Total	**326.6**	**328.9**	**-8.3**

Source: Spending Review 2010 Green Book

"We are paying, at a rate of £120 million a day, £43 billion a year in debt interest."

George Osborne

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