

The Government is committed to promoting fairness alongside flexibility and enterprise to ensure that everyone can take advantage of opportunities to fulfil their potential. Since 1997, the Government has undertaken a comprehensive programme of reform to the tax and benefit system with the aims of simplifying the system, eradicating child poverty, supporting families, promoting saving, and ensuring security for all in old age. The Government is also committed to a modern and fair tax system that ensures that everyone pays their fair share of tax. This Budget announces the next stage in modernising the tax and benefit system, offering more support for work, families and pensioners:

- **removing the starting rate and cutting the basic rate of income tax from 22 pence to 20 pence in April 2008, creating a simpler structure of two rates: a 20 pence basic rate and a 40 pence higher rate;**
- **increasing the upper earnings limit for national insurance by £75 a week above indexation in April 2008 and, from April 2009, fully aligning it with the higher rate threshold – the point at which taxpayers start to pay the higher rate of income tax, further simplifying the system;**
- **raising the aligned higher rate threshold and upper earnings limit by £800 a year above indexation in April 2009;**
- **increasing the higher personal allowances for those aged 65 or over by £1,180 above indexation in April 2008, removing 580,000 pensioners from paying tax. By April 2011, no pensioner aged 75 or over will pay any tax until their income reaches £10,000;**
- **increasing the child element of the Child Tax Credit by £150 a year above earnings indexation in April 2008, raising the child element to £2,080 a year;**
- **increasing the threshold for Working Tax Credit by £1,200 to £6,420 in April 2008, further strengthening the incentives to work for families with children and low-income working households;**
- **raising the withdrawal rate on tax credits by 2 per cent to 39 per cent, helping to retain the current focus of tax credits; and**
- **increasing the weekly rate of Child Benefit for the eldest child to £20 in April 2010, providing support to all families in line with the principle of progressive universalism.**

This Budget also announces:

- **an increase in the annual Individual Savings Accounts investment limit from April 2008 to £7,200, with an increase in the cash limit to £3,600, in order to encourage saving further;**
- **an increase in the inheritance tax allowance to £350,000 in 2010-11, to continue to provide a fair and targeted system;**
- **measures to support the third sector, including £80 million in small grants for community organisations, a campaign to drive up giving through gift aid, and gift aid changes to facilitate relationship building with donors; and**
- **further reforms to modernise the tax system and protect tax revenues, including measures to tackle avoidance.**

5.1 The Government's aim is to promote a fair and inclusive society in which everyone shares in rising national prosperity and no one is held back from achieving their potential by disadvantage or lack of opportunity. The Government is committed to advancing fairness and flexibility together, so that all people, at all stages of life, can benefit from the UK's modern and dynamic economy.

NEXT STEPS IN MODERNISING BRITAIN'S TAX AND BENEFIT SYSTEM

5.2 During the 1980s and early 1990s, while incomes rose on average, standards of living fell for many families with children and for pensioners, leading to significant rises in child and pensioner poverty. As set out in *The Modernisation of Britain's Tax and Benefit System 11*,¹ the tax and benefit system did not do enough to support families to find and progress in work, and the complex interactions of the income tax and national insurance systems created an excessive tax burden on low-income workers, and discouraged job creation at the lower end of the earnings distribution.

5.3 Since 1997, the Government has undertaken a comprehensive programme of reform to the tax and benefit system. These reforms have aimed to simplify the system, to tackle child and pensioner poverty, and to make work pay. Budget 2007 announces the next stage in these reforms, offering more support for work, families and pensioners.

Modernising the personal tax system

5.4 The Government has already introduced a number of reforms to simplify the tax and national insurance system and reduce the burden on those with low incomes, including aligning the starting point for paying both employees' and employers' national insurance contributions (NICs) with the income tax personal allowance and removing the NICs entry fee. As the next stage of reform, the Government will simplify the system further by creating two income bands covering both income tax and NICs, with additional support for low-income families delivered through tax credits.

Two rates of income tax **5.5** The Government will simplify the tax system by **removing the starting rate and cutting the basic rate of income tax from 22 pence to 20 pence from April 2008**, creating a simpler structure of two rates:² a 20 pence basic rate and a 40 pence higher rate. This is the lowest basic or standard rate of income tax for over 75 years. To continue to reward saving, the Government will maintain the existing ten pence rate of tax for savings income, which is identified separately in the income tax system.

Aligning NICs and income tax thresholds **5.6** In April 2001, the Government aligned the starting point for employee NICs with the personal allowance for income tax. As part of the next stage of reform, the Government will align the upper earnings limit (UEL) and upper profits limit (UPL) for NICs with the higher rate threshold - the point at which taxpayers start to pay the higher rate of income tax. **In April 2008, the Government will increase the UEL for national insurance by £75 per week above indexation and, from April 2009, fully align it with the higher rate threshold.** These reforms will mean that there are only two main rates of income tax, and that income tax and NICs rates will apply to the same bands of income.

Raising the higher rate threshold **5.7** **In April 2009, the Government will increase the higher rate threshold for income tax by £800 a year above indexation.**

¹ *Tax credits: reforming financial support for families*, HM Treasury, 2005.

² For all income other than savings and dividend income.

Increasing age-related allowances **5.8** Alongside tackling pensioner poverty, the Government is committed to supporting those pensioners who pay tax. Increases in the age-related income tax allowances will mean that in 2007-08 no one aged 65 or over will pay tax on an income of up to £145 a week, and around half of pensioners will pay no tax whatsoever on their income. As part of the modernisation of the tax system, **Budget 2007 announces that the age-related income tax allowances for those aged 65 or over and 75 or over will rise by £1,180 above indexation in April 2008**, thereby removing a further 580,000 pensioners from paying tax. Furthermore, **by April 2011 no pensioner aged 75 or over will pay any tax until their income reaches £10,000 a year.**

5.9 As announced in the 2006 Pre-Budget Report, all income tax personal allowances and the NICs thresholds and limits will increase in line with statutory indexation for 2007-08. There are no changes to the income tax rates for 2007-08 and the starting and basic rate limits for that year will also be increased in line with statutory indexation.

Eradicating child poverty

Progress to date **5.10** Child poverty more than doubled in the 1980s and early 1990s. The Government's first challenge was to address this underlying increase, and then make progress to eradicating child poverty by 2020. Reforms to financial support for families, combined with employment opportunity for parents, have ensured that the Government has decisively reversed the upwards trend in child poverty.

5.11 Between 1998-99 and 2004-05 (the latest data available), relative poverty fell by 700,000, the equivalent of 17 per cent (after housing costs) or 23 per cent (before housing costs). Over the same period, absolute poverty has fallen by 2 million (after housing costs), or 1.5 million (before housing costs). This was less than the Government's ambition, and the Government remains committed to doing more in order to halve child poverty between 1998-99 and 2010-11, on the path to eradication by 2020.

5.12 The Pre-Budget Report announced that, **from April 2007, the child element of Child Tax Credit will increase by £80 to £1,845 a year**, in line with the Budget 2006 commitment to raise the child element at least in line with earnings until the end of this Parliament. This represents a total increase of £400 since its introduction in April 2003. In 2007-08, a family with two young children and a full-time earner on £16,500 (half male mean earnings) will receive over £110 per week in Child Tax Credit and Child Benefit, more than double the equivalent support in 1997-98.

5.13 As part of the personal tax and benefit reforms announced in this Budget, **in April 2008 the Government will increase the child element by a further £150 a year above earnings indexation, raising it to £2,080 a year.** This will do more to support work and families and, combined with other measures announced in Budget 2007, will lift around 200,000 children out of poverty. By April 2009:

- households with children will be, on average, £250 per year better off as a result of personal tax and benefit measures announced in this Budget, and £1,800 better off as a result of all such measures since 1997; and
- households with children in the poorest fifth of the population will be, on average, £425 per year better off as a result of personal tax and benefit measures announced in this Budget, and £4,000 better off as a result of all such measures since 1997.

5.14 Table 5.1 shows the levels of support that Child Tax Credit and Child Benefit will provide for families from April 2008.

Table 5.1: Minimum annual levels of support for families from April 2008^A

Annual family income Per cent of families	up to £15,525 30	up to £50,000 79	all families 100
1 child	£3,595	£1,515	£970
2 children	£6,325	£2,165	£1,620
3 children	£9,055	£2,815	£2,270

Source: HM Treasury

A On current projections for indexation

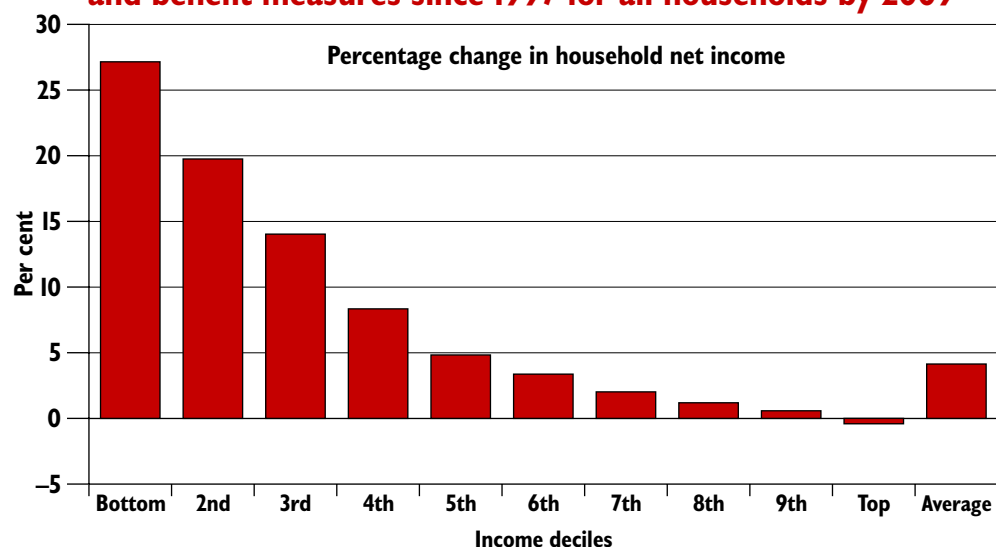
Supporting working families

5.15 Chapter 4 sets out the progress the Government has made in tackling the unemployment trap and the poverty trap, so that individuals see a financial gain from moving into, and then progressing in, work. As part of the personal tax and benefit changes announced in this Budget, **from April 2008 the income threshold at which Working Tax Credit is received in full will increase by £1,200, to £6,420 a year.** This will support work as the best route out of poverty by increasing the gain to work for many low-income households, and reducing the net tax burden for working families. To help ensure that this and other increases in tax credits retain their current focus, **from April 2008 the Government will also increase the rate at which tax credit awards are withdrawn by 2 per cent to 39 per cent.** As a result of these measures, by April 2009:

- a single-earner family with two children on male mean earnings (£35,900) will be £320 a year better off, with the direct tax burden on the family falling to 20.1 per cent, lower than any year of the 1980s and 1990s;
- a single-earner family with two children on median earnings (£27,000) will be around £500 a year better off; and
- a single-earner couple without children on half median earnings (£13,500) and receiving the Working Tax Credit will be £175 a year better off.

5.16 Chart 5.1 shows the effect by April 2009 of all personal tax and benefit measures since 1997, as a proportion of income for each income decile. Box 5.1 sets out a summary of the changes from April 2008 to Britain's tax and benefit system.

Chart 5.1: Percentage change in net income from personal tax and benefit measures since 1997 for all households by 2009



Source: HM Treasury.

Box 5.1: Modernising Britain's tax and benefit system - summary of changes

The reforms announced in this Budget represent the next stage in the Government's programme of reform to the tax and benefit system. The Government will:

- remove the starting rate and cut the basic rate of income tax from 22 pence to 20 pence, creating a simpler structure of two rates:^a a 20 pence basic rate and a 40 pence higher rate from April 2008;
- increase the upper earnings limit for national insurance by £75 a week above indexation in April 2008, and then from April 2009 fully align it with the higher rate threshold – the point at which taxpayers start to pay the higher rate of income tax, further simplifying the system;
- raise the aligned higher rate threshold and upper earnings limit by £800 a year above indexation from April 2009;
- increase the higher personal allowances for those aged 65 or over by £1,180 above indexation from April 2008;
- raise the child element of the Child Tax Credit by £150 a year above earnings indexation in April 2008, making further progress in helping families and tackling child poverty, and raising the child element to £2,080 a year;
- increase the threshold for Working Tax Credit by £1,200 to £6,420 a year in April 2008, further increasing the incentives to work for families with children and low-income working households; and
- raise the withdrawal rate on tax credits by 2 per cent to 39 per cent in April 2008, helping to retain their current focus.

Once fully implemented, these reforms to the direct tax system mean that by April 2009:

- a single-earner family with two children on male mean earnings (£35,900) will be £320 a year better off, with the direct tax burden on the family falling to 20.1 per cent, lower than any year of the 1980s and 1990s;
- a single-earner family with two children on median earnings (£27,000), will be around £500 a year better off;
- a single-earner couple without children on half median earnings (£13,500) and receiving the Working Tax Credit will be £175 a year better off;
- the numbers of children in relative poverty will be around 200,000 lower as a result of these changes;
- around 580,000 fewer pensioners will pay income tax than would otherwise be the case, so that in total only 43 per cent of pensioners will be taxpayers; and
- the tax burden on small unincorporated businesses will be reduced by £50 million in 2009-10, as the self-employed pay income tax and NICs on their business profits.

^aFor all income other than savings and dividend income.

Tax credits

5.17 A key element of tax and benefit reform has been the introduction of tax credits. The Child and Working Tax Credits were introduced in 2003 to help make work pay, tackle child poverty, and give support to most families with children. Tax credits have a number of advantages over other ways of achieving these objectives, which have been set out in previous government documents on tax and benefit modernisation.³ Higher tax allowances on their own benefit the richest most, and cannot reduce tax liability below zero. Putting all the money into universal Child Benefit would fail to target support at people who need it most. Tax credits can tailor support to family circumstances, including number of children, childcare costs or disability.

5.18 In the 2005 Pre-Budget Report, the Government announced a series of reforms to improve the tax credit system by increasing certainty for claimants. End-of-year adjustments leading to an overpayment fell by a fifth between 2003-04 and 2004-05. Once the measures announced in 2005 come fully into effect, this is expected to fall by a further third. As set out in Chapter 4, from April 2007, HM Revenue and Customs (HMRC) will introduce a four-week run-on in entitlement to Working Tax Credit from the day a claimant ceases to work over 16 hours. This will reduce the number and value of overpayments occurring when people are late in reporting that they are no longer entitled to Working Tax Credit.

5.19 In addition to these policy measures, HMRC has improved its service and communications to claimants, and its accuracy in processing awards. After the success in the implementation of the shortened five months renewal period in 2006, as announced in the 2006 Pre-Budget Report, the renewal period will be shortened again to four months in 2007. This further reduces the time when claimants are paid on potentially out-of-date information.

³ *Tax credits: reforming financial support for families*, HM Treasury, 2005.

Box 5.2: Take-up of tax credits

Take-up in the first year of the new system was higher than any previous system of income-related financial support for families in work. Data published in March 2007 showed that it has risen further since then, and that it is highest among those who need it most.

The latest figures show that:

- in 2004-05 take-up of the Child Tax Credit rose from 79 per cent to 82 per cent, with over 90 per cent of the money available being claimed; and
- take-up amongst those of incomes of less than £10,000 is now 97 per cent, up from 93 per cent in the first year of tax credits; and take-up amongst lone parents is now 93 per cent, up from 91 per cent in the first year of tax credits.

This compares to take-up of 50 per cent in the early years of Family Income Supplement, 57 per cent for Family Credit, and 62-65 per cent for Working Families Tax Credit.

HMRC has in place a programme of activity to improve take-up. For example, it puts information about tax credits in packs of information which are given to all new mothers, and advertising in parenting magazines to ensure new mothers are aware of their entitlement. HMRC are also working closely with the voluntary and community sector to encourage applications for tax credits.

In response to evidence that there are some groups with lower rates of take-up, including some ethnic minority groups and people without children, HMRC is testing more effective ways of reaching these people to encourage greater take-up.

SUPPORT FOR FAMILIES AND YOUNG PEOPLE

Child benefit 5.20 To provide support for all families in line with the principle of progressive universalism, **this Budget announces that the weekly rate of Child Benefit for the eldest child will rise to £20 in April 2010.**

5.21 In addition, the Government recognises the importance of a healthy diet in the final weeks of pregnancy and the additional costs faced by parents when their children are born. Low-income families may already claim the Sure Start Maternity Grant, worth £500 per child, to help with these additional costs. Additional support for all families was announced at the 2006 Pre-Budget Report: **from April 2009, every mother-to-be will become eligible for Child Benefit from week 29 of their pregnancy, so that women will be up to £200 better off by the birth of their first child, and up to £130 better off at the birth of subsequent children.**

Financial support for young people

5.22 Globalisation and rapid technological change are presenting new challenges for the UK, with the labour market requiring highly skilled individuals to meet these challenges. Achieving world-class skills in the UK will require improving the skills of young people flowing into employment. Improving the number of young people continuing in education and training after the end of the compulsory school age will provide the foundation to improve the skills of young people. In support of this, the Government is committed to a vision of a single, coherent system of financial support for 16-19 year olds, which ensures that all young people have the support and incentives they need to participate and achieve in education and training.

Engaging the most disadvantaged young people **5.23** Evidence suggests that where young people spend prolonged periods unemployed or inactive, it has a negative impact on their employment prospects and life chances. Since April 2006, the Government has been piloting Activity Agreements and Allowances targeted on the most disadvantaged 16-17 year olds. These schemes have extended conditional financial support to this group, setting a clear expectation that young people progress into learning, and offering them the financial support and opportunity to do so. **Budget 2007 announces an extension of the pilot into the 2007 CSR period. This Budget also announces Activity Agreements for 16 and 17 year olds not in education, employment or training and in receipt of Jobseekers' Allowance (severe hardship), to help them to re-engage, and take up their statutory right to an appropriate place in education or training, or find a job with training.** The Green Paper, *Raising the participation age*, to be published on 22 March 2007, will consult on raising the compulsory age for participation in education and training to 18.

Support for children and young people

Review of children and young people **5.24** Budget 2006 launched a joint HM Treasury and Department for Education and Skills (DfES) policy review on how to secure further improvement in outcomes for children and young people. The analysis of this policy review has played an important part in informing the key announcements that the Government is making on education and children in this Budget. The final report of the review will be published later in the spring. Further details on the review are set out in Chapter 6.

Children in care **5.25** The state has special responsibility for children in care, and yet outcomes for this group are extremely poor, both in absolute terms and relative to their peers. For this reason, these young people sit at the heart of the Government's wider programme to tackle the poor outcomes and social exclusion of the most vulnerable groups in society. Fulfilling the commitment in the Schools White Paper⁴ to consult on a wide-ranging set of proposals to transform outcomes for children in care, the Government published the Green Paper, *Care matters: Transforming the lives of children and young people in care*, for consultation in October 2006.

Budget-holding lead professionals **5.26** *Support for parents: the best start for children*⁵ set out an ambition to promote greater personalisation of services. It announced a series of single account-holder pathfinders to test whether better service packages for children, young people and families can be delivered by giving lead professionals a budget with which to procure goods and commission services directly from providers. £10 million in additional funding over two years has been made available to support the pilots. Since June 2006, 15 pilots have been established in 16 Local Authorities,⁶ to run until April 2008.

Parent Support Advisers **5.27** *Support for parents* also announced £20 million to support the piloting of a new school-based outreach role, Parent Support Advisers, in over 600 primary and secondary schools in the most deprived areas. This new, preventative role is intended to support children and families where there are early signs that they could benefit from additional help. A total of 20 local areas have been selected to run the pilots and 615 schools now have Parent Support Advisers in place. It is anticipated that as many as 900 schools will have Parent Support Advisers provision during 2007.

Listening services **5.28** The National Society for the Prevention of Cruelty to Children (NSPCC) runs listening services to provide support and advice for children and young people. **This Budget provides additional resources to help support an expansion of these services.**

⁴ *Higher Standards: better schools for all*, Department for Education and Skills, October 2005.

⁵ *Support for parents: the best start for children*, HM Treasury and Department for Education and Skills, December 2005.

⁶ Blackpool, Bournemouth, Poole, Brighton & Hove, Derbyshire, Devon, Gateshead, Gloucestershire, Hertfordshire, Knowsley, Leeds, Redbridge, Telford & Wrekin, Tower Hamlets, Trafford and West Sussex.

Childcare and work-life balance

Delivering the ten year strategy **5.29** Flexible, affordable and high-quality childcare provision is an important element of the Government's strategy to provide support to families and eradicate child poverty. *Choice for parents, the best start for children: a ten year strategy for childcare*,⁷ published alongside the 2004 Pre-Budget Report, set out the Government's long-term vision for childcare and early years services.

5.30 The Government is committed to ensuring that parents have greater choice and flexibility in balancing work and family life. **From this April, paid maternity leave will be extended from six to nine months**, and the Government has a goal of 12 months of paid maternity leave by the end of the Parliament. The right to request flexible working is currently available to parents of children under six, and will be extended to carers from April. The Government will also continue to examine the case for extending the right to request flexible working to parents of older children in the future.

5.31 As set out in Chapter 6, this Budget announces the overall resource plans for the DfES for the 2007 CSR period. In order to achieve and build on the commitments made in the ten-year strategy for childcare, **this Budget announces significant additional funding for Sure Start, childcare and early years of at least £340 million by 2010-11 compared with 2007-08 - over £1.6 billion by 2010-11. Final allocations will be announced in due course.**

5.32 There are currently over 1,150 Sure Start Children's Centres across the country, reaching over 925,000 children and offering integrated childcare, health, parenting and family support. The additional resources announced in this Budget will deliver a nationwide network of 3,500 centres as planned by 2010 – one in every community of the country – as well as additional parenting support for fathers and those parents who need it most.

Affordability for parents **5.33** The Government wants families to be able to afford flexible, high-quality childcare that is appropriate to their needs, and continues to believe that the childcare element of the Working Tax Credit is the most effective way of delivering support for low-to-moderate income families. This offers parents support with up to 80 per cent of costs, up to a limit of £300 per week (£175 for one child). Alongside this, the £55 per week income tax and NICs exemption for employer-supported childcare is improving childcare affordability for parents. From this April, a wide range of childcare providers will be able to register on the voluntary part of the Ofsted Childcare Register giving many, such as providers of activity-based childcare, their first opportunity to demonstrate to parents that essential standards are being met. Parents will be able to claim the childcare element of the Working Tax Credit and income tax and NICs exemptions on employer-supported childcare in respect of costs relating to providers on the register, increasing access and affordability further. In addition, **this Budget offers free childcare places for up to 50,000 workless parents undertaking training, to enable more parents to move back into work.**

FAIRNESS FOR DISABLED PEOPLE

5.34 The Government is committed to improving opportunities for disabled people, as well as improving their rights and outcomes. The proposals set out in the Welfare Reform Green Paper (see Chapter 4 for further detail), including the reforms to incapacity benefits contained within the Welfare Reform Bill, will develop opportunities for disabled people to participate fully in society. This will entail putting in place extensive support to help individuals re-engage with the labour market and gain employment, while providing

⁷*Choice for parents, the best start for children: a ten year strategy for childcare*, HM Treasury, Department for Education and Skills, Department for Work and Pensions, Department of Trade and Industry, December 2004.

adequate support to those who are not able to work. The additional provisions of the Disability Discrimination Act 2005 came into force from December 2006. The new Disability Equality Duty means that all public sector organisations now have a statutory requirement to promote equality of opportunity for disabled people, eliminate unlawful harassment and publish a Disability Equality Plan.

Improving the life chances of disabled people **5.35** The Office for Disability Issues (ODI), set up in December 2005, has a strategic role across government, and is taking forward the recommendations of the 2005 Strategy Unit report. A new advisory non-departmental public body, *Equality 2025: the United Kingdom Advisory Network on Disability Equality*, was launched in December 2006 to ensure that the views of disabled people are heard. The ODI is currently consulting on possible indicators to measure equality for disabled people by 2025.

Independent living **5.36** The Government is committed to ensuring disabled people have choice and control over the support they need to live their everyday lives. Individual budget pilots, running in 13 Local Authorities, are examining the effectiveness of giving individuals a choice of their budget in the form of cash, services, or a combination of the two. One of the three strands of the *Children and Young People's Review* (see Chapter 6 for further detail) focuses on support for disabled children, empowering them and their families to influence their own provision, and encouraging earlier intervention and best practice support. The *Mental Health and Employment Review* (see Chapter 4 for further detail) is examining ways of helping those with mental health conditions into work. These reviews are being taken forward as part of the 2007 CSR.

PROMOTING SAVING, ASSET OWNERSHIP AND INCLUSION

5.37 The Government seeks to support saving and asset ownership for all across the lifecycle – from childhood, through working life and into retirement. Since 1997, the Government's savings strategy has focused on improving the environment for saving, developing a range of savings opportunities suitable for each life stage, providing adequate incentives for saving through the tax and benefit system, and empowering individuals with the capability to make the right saving choices. In addition, the Government aims to promote financial capability and financial inclusion – to ensure that people have the knowledge, skills and confidence to manage their finances, and that they have access to appropriate financial products and services.

Promoting saving and asset ownership for all

Child Trust Fund **5.38** The Child Trust Fund (CTF) was introduced in April 2005 to promote saving and financial education and ensure that in future all children have a financial asset at age 18. Under the scheme, all newborn children receive £250 to be invested in a long-term savings and investment account, and children from lower-income families receive £500. Budget 2006 announced further payments at age seven, of £250 for all children, with children from lower-income families receiving £500.

5.39 Around 2.5 million CTF accounts are now open. In the first year of operation, over three quarters of parents opened their child's account and over a third of children received an extra payment from the Government.⁸ To raise awareness and participation among parents, the Government ran a successful CTF Week in January 2007, which received wide coverage.

5.40 The Government recognises that children in care are a particularly vulnerable group. In view of this, the Government announced in October 2006 that it would provide an extra £100 per year to every child who spends the year in care, in order that their CTF provides a more significant asset for them to access on entering adult life. Following consultation, **the scheme will come into effect for children in care from 1 April 2007.**

⁸ *Child Trust Fund: Statistical Report 2006*, HM Revenue & Customs, September 2006.

5.41 Budget 2006 announced that the Government was exploring the use of a 'Schools Money Week' as a focus for financial education. The Government is continuing to work with financial education bodies in developing tailored CTF resources to support this initiative.

Individual Savings Accounts **5.42** Individual Savings Accounts (ISAs) were introduced in 1999 as a replacement for Tax-Exempt Special Savings Accounts (TESSAs) and Personal Equity Plans (PEPs). The objective has been to develop and extend the savings habit and to ensure that tax relief on savings is more fairly distributed. The evidence shows that ISAs have been successful in meeting these objectives: for example, over 17 million people now have an ISA, with over £220 billion subscribed since their launch. ISA and PEP savings are supported by an estimated £2.1 billion each year in tax relief.

5.43 In order to build on this success, the Government announced in the Pre-Budget Report that, following its review of ISAs, it will simplify the ISA regime, make it more flexible for savers and providers, and further promote saving by introducing the following package of reforms:⁹ to make ISAs permanent beyond 2010; bring PEPs within the ISA wrapper; remove the Mini/Maxi distinction within ISAs; allow transfers from the cash into the stocks & shares component of ISAs; and allow CTF accounts to roll over into ISAs on maturity.

5.44 Building on this package of reforms, and in order to encourage further saving in ISAs, **the Government will raise the annual ISA investment limit from April 2008 to £7,200, with an increase in the cash limit to £3,600.** This will benefit around 5 million individuals who are currently making full use of either their cash or overall investment limits. In response to stakeholder views, the Government will also extend the reform to allow transfers from cash into stocks & shares to include all cash held in ISAs, not just that subscribed in previous tax years. The Government will implement the package of ISA reforms from April 2008. Draft implementing legislation is being published alongside the Budget.

Saving Gateway **5.45** Through the Saving Gateway, the Government is exploring the use of matching (a Government contribution for each pound saved) to encourage saving among lower-income households and to promote engagement with mainstream financial services. Evidence from an initial pilot showed that matching could encourage genuinely new savers and new saving.¹⁰

5.46 A second pilot is now drawing to a close. Early evidence suggests that the scheme has brought some individuals into contact with a bank for the first time, and that savers have found the experience useful in familiarising themselves with the mechanics of saving. A full evaluation of the second pilot is due to be published in the spring and the Government will make an announcement on the next steps in summer 2007.

Promoting financial capability

5.47 The Government published its long-term approach for financial capability in January of this year.¹¹ Its aim is to ensure that consumers have the knowledge, skills and motivation to manage their finances – with the potential for securing lasting benefits for individuals, the financial services industry and the wider UK economy. The Government's long-term aspirations are to ensure that:

- all adults have access to high quality generic financial advice to help them engage with their financial affairs;

⁹ *Individual Savings Accounts: proposed reforms*, HM Treasury, December 2006.

¹⁰ *Incentives to save: Encouraging saving among low-income households*, University of Bristol, Personal Finance Research Centre, March 2005.

¹¹ *Financial Capability: the Government's long-term approach*, HM Treasury, January 2007.

- all children and young people have access to a planned and coherent programme of personal finance education, so they leave school with the skills and confidence to manage their money well; and
- a range of Government programmes is focused on improving financial capability, particularly to help those who are most vulnerable to the consequences of poor financial decisions.

5.48 The Government believes that there is currently a lack of access to generic financial advice, i.e. personalised but unregulated advice that helps consumers to understand their financial needs and take appropriate action. To address this, the Government has launched an independent feasibility study, led by Otto Thoresen, Chief Executive of AEGON UK, to research and design a national approach to generic financial advice. The study will report around the end of the year. The Government has also established a ministerial group, chaired by the Economic Secretary to the Treasury, to develop and coordinate the Government's work in this area. Building on consultation, the work of the ministerial group, and the recommendations of the Thoresen study, the Government will publish a financial capability action plan around the end of the year.

Promoting financial inclusion

5.49 The Government is committed to ensuring that everyone has access to appropriate financial products and services. On 14 March 2007, the Government announced a new policy framework for the spending period from 2008-2011. This includes:

- a new Financial Inclusion Fund to maintain financial inclusion activity at the current level of intensity;
- the continuation of the Financial Inclusion Taskforce to monitor progress against existing initiatives and advise the Government on new priorities and directions for policy; and
- a new cross-governmental ministerial working group that will develop a financial inclusion action plan for implementation after 2007 CSR.

5.50 Building on this policy framework, the Government will shortly publish a new financial inclusion strategy. This will be followed by a detailed action plan later in the year, drawing on emerging findings on the success of existing initiatives, and taking into account the work of the Financial Inclusion Taskforce. In the longer term, work on financial inclusion will be mainstreamed into departmental budgets.

Access to banking **5.51** Lack of access to banking services imposes costs on those who can least afford them. In December 2004, the banks and the Government agreed to work together towards a goal of halving the number of adults in households without a bank account, and making significant progress within two years. The Financial Inclusion Taskforce has reported that steady progress is being made towards the shared goal and definitive evidence will be available shortly.

5.52 In December 2006 a working group on Automatic Teller Machines (ATMs), chaired by the Rt Hon John McFall MP, reported that, while most low-income areas are relatively well-served by free ATMs, a small but significant number of areas are currently without convenient access to free machines. The working group concluded that around 600 new free ATMs would meet access gaps in such areas. As of 1 March 2007, banks and independent ATM operators have made progress to install nearly 400 of the required new free ATMs.

Access to affordable credit 5.53 Many low-income households rely on credit products with interest rates of over 100 per cent. The Financial Inclusion Fund has been used to establish a Growth Fund of £36 million to support third sector lenders in providing affordable and appropriate credit. Over 100 credit unions and community development finance institutions have received funding, and over 12,000 affordable loans have been made to financially excluded people. In December 2006 the Government announced further funding for the training requirements of staff and volunteers working in third sector lenders. A training needs analysis for the sector is being conducted.

5.54 In order to reduce some of the increased risk and cost associated with lending to vulnerable groups, the Government has implemented a scheme where, under certain circumstances, third sector lenders can apply for repayment by deduction from benefits, where normal repayment arrangements have broken down. The scheme came into force in December 2006.

5.55 The Government also recognises the damage inflicted on individuals and neighbourhoods by illegal lending, and has announced that projects to tackle illegal lending and provide support for victims will be rolled out to every region of the country. The Department of Trade and Industry (DTI) and HM Treasury are now working with Local Authorities and representative bodies to identify suitable regional locations for the operation of the projects, and to bring them into operation as soon as possible.

Access to money advice 5.56 Credit is a useful tool for managing expenditure for most people, but some have difficulty managing their borrowing and become over-indebted. The Government has committed £47.5 million of the Financial Inclusion Fund to increase the supply of free face-to-face money advice. There are now 385 full-time equivalent advisers in post, rising to more than 500 by the end of April 2007, and over 18,000 clients have been advised. The Government has also awarded £6 million to organisations across England and Wales to pilot debt advice outreach. Recent data shows that over 8,000 clients have been helped, more than 90 per cent of them financially excluded.

Now let's talk money campaign 5.57 To assist financially excluded people to access mainstream banking and credit products, the Government has launched the *Now let's talk money* campaign. The £5.4 million campaign, being delivered through the Department for Work and Pensions (DWP), will work with trusted intermediaries in day-to-day contact with the financially excluded to achieve an increase in the awareness and take-up of mainstream financial services across England, Wales and Scotland.

Pomeroy Review 5.58 In November 2006, the Government asked Brian Pomeroy, the Chairman of the Financial Inclusion Taskforce, to investigate the Christmas savings market to look at the reasons why people opt to use hamper schemes and similar vehicles instead of mainstream financial services products and, in the light of this, to consider how the savings needs of this group of consumers might be better met. The review is expected to report shortly. Separately the DTI has been working closely with the hamper companies to develop an industry-led scheme to ensure consumers' interests are fully protected through the establishment of secure, ring-fenced accounts.

FAIRNESS FOR PENSIONERS

5.59 One of the most significant demographic trends projected to occur over the next ten years is the ageing of the population. For example, by 2017 the number of those aged over 85 will increase by over a third.¹² To respond to the needs of today's older people and the challenges posed by demographic change, the Government has developed its Opportunity Age¹³ strategy, which promotes independence and well-being in later life and aims to ensure that the Government adapts to, and benefits from, an ageing society. A comprehensive programme of reforms seeks to ensure that pensioners can share in rising national prosperity, and that older people are able to play a full and active role in society.

5.60 The Government is committed to tackling pensioner poverty, rewarding saving, and helping extend working lives to enable people to meet their retirement income aspirations. Its strategy for pensioners is based on the principle of progressive universalism, providing support for all and more for those who need it most, through both financial support, access to services, and action to tackle age discrimination, improve public services, and encourage and support healthy active ageing.

Fairness for today's pensioners

Security for the poorest pensioners

5.61 The Pension Credit, launched in 2003, is the foundation through which the Government provides security for the poorest. It is made up of the standard minimum guarantee (Guarantee Credit), which ensures a minimum income for those aged over 60, and the Savings Credit, which rewards those who have built up small savings for retirement. 2.7 million pensioner households currently receive Pension Credit: 2.1 million receive the Guarantee Credit, a take-up level achieved a year ahead of target, and 1.9 million receive the Savings Credit.

5.62 In 2004, the Government committed to uprating the Guarantee Credit in line with earnings until 2008. Accordingly, from April 2007, it will rise to £119.05 for single pensioners and £181.70 for couples. From April 2007, the Savings Credit will also rise to a maximum of £19.05 a week for single pensioners and £25.26 for couples. The Pensions White Paper¹⁴ announced that the Guarantee Credit will be uprated in line with earnings over the long term in order to ensure that the gains made against pensioner poverty are secure into the future.

5.63 Concentrating resources on the poorest pensioners has contributed significantly to reductions in pensioner poverty. Between 1996-97 and 2004-05, over 1 million pensioner households were lifted out of relative poverty and 2 million pensioner households were lifted out of absolute poverty. Half a million pensioner households have been lifted out of relative low-income poverty since the introduction of Pension Credit. The risk of a pensioner household being poor has fallen to 17 per cent, and a pensioner is now no more likely to be poor than the population as a whole.

Support for all pensioners

5.64 The Government has continued to build on the foundations of support for retirement incomes provided by the basic and additional state pensions. Steps that have already been, or are being, taken to provide support for all pensioners include:

- guaranteeing that the April increase in the basic state pension will be in line with the Retail Prices Index for the previous September, or 2.5 per cent, whichever is higher. From April 2007, the basic state pension will rise to £87.30. As described later in this chapter, the Government has also committed to uprating the basic state pension by average earnings in the longer term;

¹² *Long-term opportunities and challenges for the UK: analysis for the 2007 Comprehensive Spending Review*, HM Treasury, November 2006.

¹³ *Opportunity Age: Meeting the challenges of ageing in the 21st century*, Department for Work and Pensions, March 2005.

¹⁴ *Security in retirement: towards a new pensions system*, Department for Work and Pensions, May 2006.

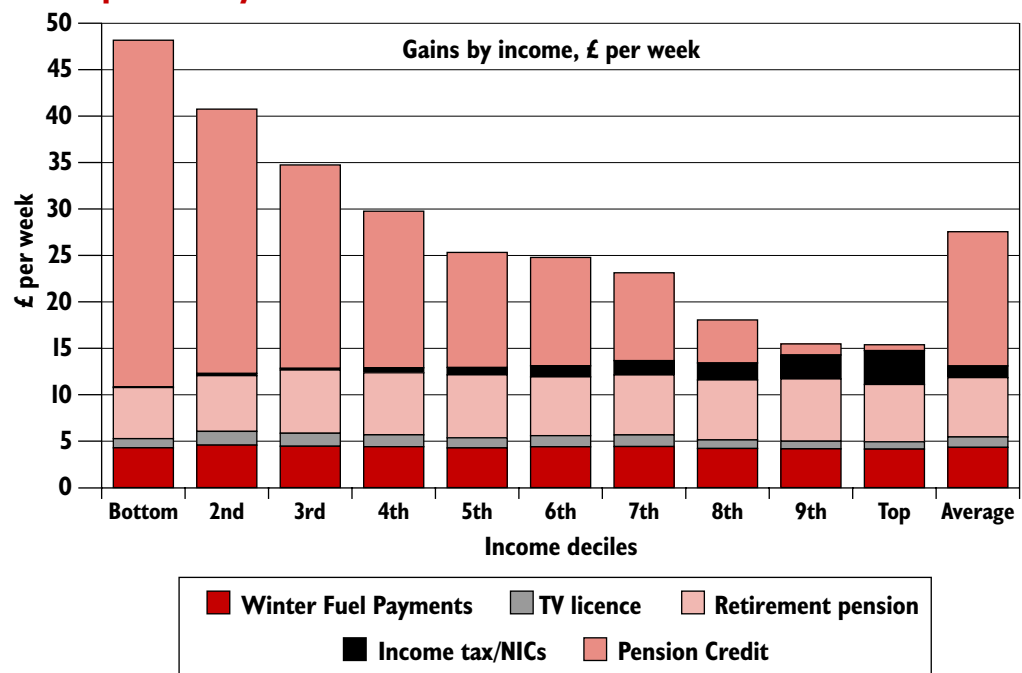
- supporting pensioners who pay income tax, by **increasing the higher personal allowances for those aged 65 or over by £1,180 above indexation in April 2008**, thereby removing 580,000 pensioners from paying tax and ensuring 43 per cent of pensioners overall pay no tax. **By April 2011, no pensioner aged 75 or over will pay any tax until their income reaches £10,000;**
- the introduction and extension of Winter Fuel Payments of £200 for households with someone aged 60 or over, rising to £300 for households with someone aged 80 or over, for the duration of this Parliament;
- free television licences for those aged over 75, and free prescriptions and eye tests for those aged 60 and over;
- ensuring that those entering hospital receive their full entitlement to the basic state pension and some other benefits for the duration of their stay;
- introducing free off-peak local area bus travel, and committing to extend this to off-peak nationwide bus travel from April 2008, for those aged over 60 and all disabled people in England; and
- to support the needs of elderly people within their own homes, **the Government will reduce the rate of VAT for certain home adaptations to 5 per cent** – the lowest rate available under EU VAT agreements. This 5 per cent rate will operate alongside the existing zero rate for certain goods and services provided for disabled people.

Financial Assistance Scheme 5.65 The Financial Assistance Scheme was established in 2004 to assist those who lost significant amounts when their pension schemes started winding up between 1 January 1997 and 5 April 2005 as a result of the sponsoring employer becoming insolvent. Budget 2007 announces that the Government will now **extend the Financial Assistance Scheme further so that all members of affected pension schemes receive assistance of 80 per cent of the core pension rights accrued in their scheme. The cap on maximum assistance will be increased to £26,000 and the *de minimis* rule that excludes those whose FAS payment would be £10 or less a week will be removed.** This includes an additional 85,000, ensuring all 125,000 who lost their pensions will benefit, bringing total long-term expenditure to £8 billion. **The Secretary of State for Work and Pensions will set up a review to look at making best use of assets within these schemes, which will report later this year.**

Helping vulnerable households heat their homes 5.66 The Government is committed to ensuring that the most vulnerable households can afford to heat their homes to an adequate standard. The Pre-Budget Report announced a new investment of £7.5 million to fund projects using an area-based approach to identify households in fuel poverty and give them the right coordinated help. This will target 300,000 of the most vulnerable households to give them the assistance they need. This adds to the 1.1 million households who have already been helped by Warm Front, which aims to help low-income households, including the poorest pensioners, heat their homes to an adequate standard of warmth by providing heating, energy efficiency measures, and benefit entitlement checks.

Effects of measures to support pensioners 5.67 As a result of measures implemented since 1997, the Government is spending around £11.5 billion a year more in real terms on pensioners, focusing support on those who need it most. From April 2007, the poorest third of households will be on average £2,200 a year, or around £42 a week, better off. Overall, pensioner households will be on average £1,500 per year, or around £29 a week better off. Women pensioners have also particularly benefited from the Government's support for older people. 3.2 million women have gained an average of £32 a week, while 1.1 million men are £30 per week better off. Chart 5.2 shows the distributional impact of the Government's measures to support pensioners.

Chart 5.2: Gains to pensioner households from tax and benefit policies by 2007



Fairness for tomorrow's pensioners

5.68 Since 1997 the macroeconomic environment has been characterised by low inflation and high employment, both key to economic stability. This has provided the platform on which individuals can now confidently plan for retirement, with more people having the ability and opportunities to save. Building upon these achievements, the Government is committed to providing a clear retirement framework, enabling individuals to take personal responsibility for their decisions around how much to save and when to retire.

Pension reform 5.69 Following the recommendations of the Pension Commission, the Government published a White Paper¹⁵ outlining proposed reforms to the state and private pensions systems. The Pensions Bill currently before Parliament introduces reforms to state pensions, including:

- re-linking the basic state pension to average earnings. The Government's objective, subject to affordability and the fiscal position, is to do this in 2012 but, in any event, by the end of the next Parliament at the latest;
- streamlining the contribution conditions to the basic state pension by reducing the number of years needed to qualify to 30; and
- gradually raising the state pension age in line with life expectancy.

5.70 DWP is taking forward reforms to the private pension system, including, as outlined in the December 2006 White Paper¹⁶, proposals for personal accounts. These would:

¹⁵ *Security in retirement: towards a new pensions system*, Department for Work and Pensions, May 2006.

- for the first time, give eligible employees the right to a workplace pension with a minimum level of employer contribution, either in an existing scheme or in personal accounts;
- utilise the National Pension Savings Scheme approach to delivering personal accounts. Individuals will not have a choice of pension administrator, but they will have a choice of investments;
- utilise private sector expertise to design and implement personal accounts through a delivery authority; and
- be designed to minimise the administrative burden on all employers, especially small employers.

5.71 The consultation period for the Personal Accounts White Paper ended on 20 March 2007. DWP will respond to this consultation later this year.

Pensions tax relief 5.72 Successive governments have provided generous tax relief to encourage pension saving. A radical simplification of the pensions tax rules came into effect on 6 April 2006 (A-day). To provide greater clarity, the Government has restated the principles that underpin this tax regime¹⁷ – these are set out at Box 5.3. The Government will continue to base any further reforms on these principles. In addition, the Government will implement a package of technical improvements to the regime announced at the Pre-Budget Report and simplify some of the rules around payments of non-cash benefits.

¹⁶ *Personal Accounts: a new way to save*, Department for Work and Pensions, December 2006.

¹⁷ Speech by the Economic Secretary to the Treasury, Ed Balls MP, to the NAPF Investment Conference, Edinburgh, 15 March 2007.

Box 5.3: Tax relief for pension saving - principles

A principled and transparent pensions tax regime is crucial to providing the right environment and incentives to encourage long-term saving. Tax relief on pensions products, currently worth £14 billion per year, is a long-standing part of the UK pensions landscape. It is a valuable tool that raises incentives to save in a pension relative to other products, encourages employer engagement, and sits alongside the Government's role in tackling pensioner poverty.

Following many years of change and reform at the margins, the pensions tax rules had become too complex. In response to this, and following extensive consultation, the Government introduced a new regime that radically simplified the pensions tax rules from 6 April 2006. In making these changes, the Government's ambition has been to maintain stability, fairness and encourage long-term saving, providing a transparent and flexible regime, and enabling individuals to make informed choices about pension saving. The following key principles have guided, and continue to underpin, the Government's approach to pensions tax relief:

- generous tax relief is provided to support pension saving to produce an income in retirement. Pension saving is not, however, provided to support pre-retirement income, asset accumulation or inheritance;
- pensions are provided with more favourable tax treatment, compared to other forms of saving, in recognition that they are less flexible than other savings, and are locked away until retirement;
- incentives for employer contributions are provided as it is more efficient for pensions to be provided on a collective basis through the employer; and
- the cost of pensions tax incentives must be affordable and fall within current fiscal projections.

The Government recognises the importance of a stable environment that allows the pensions industry to plan ahead and minimise disruption to the regimes already in place that are working well. At the same time, the Government will need to respond to circumstances that move away from the above principles, or where the market seeks to identify loopholes in legislation that permit behaviours clearly outside the original intention of the legislation. In making these principles transparent, Government is seeking to provide greater clarity for the industry.

Alternatively Secured Pensions 5.73 In line with the principle that pensions tax relief is provided to produce an income in retirement, the Government will bring forward legislation to make changes to the rules governing Alternatively Secured Pensions (ASPs). This will introduce a new requirement to withdraw a minimum level of income each year from an ASP fund. The facility to transfer funds on death as a lump sum to pension funds of other members of the scheme will be removed from the authorised payments rules, with these payments attracting an unauthorised payments charge. Following consultation with industry, **there will be special rules for those scheme members who cannot be traced at age 75 and the level of the minimum income will be set at 55 per cent of the level of the annual amount of a comparable annuity for a 75 year old. Rules will be introduced to deal with the interaction of inheritance tax and the unauthorised payments charge. The Government will consult on further measures to prevent the inheritance of tax-relieved pension savings.**

Tax-relieved term assurance policies 5.74 As set out in Box 5.3, pensions tax relief is provided to support pension saving to produce an income in retirement. In the 2006 Pre-Budget Report, the Government set out its concerns over a new and fast-growing trend: life insurance policies providing lump-sum death benefits alone being offered as personal pension arrangements eligible for pensions tax relief. The Government announced that it would work with the industry to address this issue and explore how the principles for pensions tax relief should be applied to pensions term assurance contracts. Following detailed consultation, it has become clear that providing a meaningful link between term assurance contracts and pension saving is not practical or commercially viable, due to the additional administrative burdens this would impose. This conclusion is consistent with the experience pre-A-day, where rules for members of personal pension schemes requiring term assurance premiums to be no more than 10 per cent of pension contributions made the products not commercially viable. Therefore, in line with the principle that pensions tax relief is provided to produce an income in retirement, and to provide certainty going forward, **the Government confirms that it will no longer provide tax relief on individuals' contributions that are used to fund personal term assurance policies.** For contributions under occupational pension schemes, this will apply where the insurer received the application for the policy on or after 29 March 2007. For contributions under other registered pension schemes, this will apply where the insurer received the application for the policy on or after 14 December 2006. There is no change for employers, so death-in-service benefits and other death benefits funded by the employer will not be affected by this measure.

Information and advice 5.75 Personal accounts are to be delivered without the need for regulated financial advice, ensuring that the costs of pension provision are minimised. The combination of the employer contribution, tax relief, and lower charges, combined with a reformed state pension system, will mean that the large majority can expect to benefit from saving in personal accounts, subject to factors such as growth in the stock market. The Government is currently consulting on what sort of information should support personal accounts, and the responsibilities of different organisations in communicating this information, and will develop an evidence-based information strategy for both pensions and personal accounts over the next year. This will complement the Government's Financial Capability Strategy and the work to develop generic advice.

SUPPORTING CHARITIES AND THE THIRD SECTOR

5.76 A vibrant third sector is a key component of a fair and enterprising society, and the Government is continuing to support the third sector to build communities, empower marginalised groups of people, and contribute to the design and delivery of key public services. The Government is also working to support a philanthropic culture of volunteering and giving, which plays a pivotal role in enabling the third sector to flourish and benefit from connections to the corporate sector and the general public.

Working to support the third sector

Third Sector Review 5.77 Budget 2006 announced that the largest ever consultation with the third sector would shape the outcomes of a review into the future role of the third sector in social and economic regeneration, to feed into the 2007 CSR. The Government listened to all parts of the sector and the interim report¹⁸ of the first stage of this consultation, published alongside the 2006 Pre-Budget Report, set out the most consistent messages from across the 93 consultation events and over 250 written submissions received. The interim report also announced measures to

¹⁸ *The future role of the third sector in social and economic regeneration: interim report*, HM Treasury/Cabinet Office, December 2006.

boost communities, through a Community Assets Fund, and additional funding for the Safer and Stronger Communities block of local area agreements. **This Budget announces additional support to promote community action and voice with £80 million to be made available to provide core funding to grass-roots community organisations.** The funding will be run by the Office of the Third Sector, and channelled through third sector partners at a local level [such as Community Foundations].

5.78 Following the interim report, a second stage of analysis and engagement with the third sector is taking place and the final recommendations of the third sector review will be published later in the year under the five key themes of the review: enabling voice and campaigning; strengthening communities; transforming public services; encouraging social enterprise; and supporting the environment for a healthy third sector.

Futurebuilders 5.79 The interim report also acknowledged the role that many third sector organisations play in delivering public services, designing services, and giving voice and advocating on behalf of service users. The Government supports this role with capacity building investment through the Futurebuilders fund, **which will be open to all third sector organisations from spring 2008.** This will particularly help organisations working on environmental activities and those involved in community leisure and sports, many of which are social enterprises.

Social enterprises 5.80 Social enterprises are a key component of the third sector, but also make up a part of the mainstream business landscape. Encouraging social enterprises also remains a key theme of the third sector review. In November 2006, the Government published an action plan detailing measures to support and promote a dynamic and sustainable social enterprise sector.¹⁹ Chapter 3 contains both important business tax reforms, with relevance for social enterprises, and progress on the operational review of the Community Investment Tax Relief (CITR) scheme, which encourages private investment in small and medium-sized enterprises, including social enterprises, in disadvantaged communities.

5.81 There is evidence to suggest that levels of equity investment in social enterprises are significantly lower than in other enterprises. The Office of the Third Sector will consider the evidence for whether this is due to market imperfections in the supply of equity investment, or whether social entrepreneurs feel that traditional forms of equity do not meet their needs. If the evidence supports the case for further government intervention in the supply of equity, the Government will examine whether, subject to state aids approval, the CITR model might be enhanced to encourage this form of investment, for example by increasing the limit for Community Development Finance Institutions making equity investments in social enterprises.

Invest to Save Budget 5.82 The Government also wants to promote partnership-working with the third sector at all levels. Budget 2006 announced a ninth Invest to Save Budget (ISB) allocation round with a focus on promoting partnerships between third sector organisations and Local Authorities. **This Budget announces that £11 million from the ISB fund will go to 24 new projects supporting innovative approaches to the delivery of local services by third sector organisations.** This funding round has allocated the remaining funding in the ISB pot, which since 1998 has allocated over £100 million to the third sector.

¹⁹ *Social enterprise action plan: scaling new heights*, Cabinet Office, November 2006.

Volunteering and giving

Volunteering 5.83 The Government has invested significantly in increasing the number and quality of volunteering opportunities available, and increasing awareness and understanding of the benefits of volunteering to a diverse range of groups. This includes investment in v²⁰ to create a framework to support youth volunteering, which has so far generated 100,000 volunteering opportunities. Government investment of up to £100 million in v includes a fund available to match contributions from business, and v have raised over £20 million from 63 private companies. Building on this support, at the 2006 Pre-Budget Report, the Government signalled its intent to examine incentives to further encourage volunteering, including by creating a new pathway to university where students receive a discount on their tuition fees in return for volunteering. Following initial consultation with the third sector, v will now conduct a consultation with young people on the design of a potential scheme.

Supporting giving 5.84 **There is much greater scope for charities to claim additional funds through gift aid. The Government will consult with the charitable sector on measures to increase take-up of gift aid and conduct an awareness-raising campaign. The Government will also work with the sector on payroll giving, and publish guidance on tax efficient giving for individuals.** In addition, the Government recognises the need for charities to build ongoing relationships with their major donors, giving them the opportunity to thank their donors and to demonstrate how effectively donations are used, as well as to encourage continued giving. To facilitate the ability of charities to build relationships with donors, **this Budget announces an increase in the value of benefits that donors may receive, in consequence of a donation made within the gift aid regime, to 5 per cent of the donation for those donating £1,000 or more, with the upper limit on benefits received increased to £500.**

Increasing donations to universities 5.85 The Government is aware of the appetite in the higher education sector, in particular to increase voluntary donations. However, the sector may not be exploiting existing incentives for giving, particularly gift aid, to their full capacity. The Government will therefore seek to engage with universities, as part of the wider campaign on gift aid, to increase awareness and application of gift aid, and other incentives for giving to help drive up donations to this sector.

Guidance for giving by businesses 5.86 To support the corporate sector in its work with the third sector, and in response to questions raised during the third sector review consultation regarding tax incentives for employers who want to give to charity or encourage employees to volunteer, **the Government will soon publish updated details that illustrate the incentives for giving and seconding of employees by businesses.**

Unclaimed assets 5.87 Following the announcement in the 2006 Pre-Budget Report that the Government intends to bring forward legislative proposals to enable the banking industry to set up an unclaimed assets scheme, HM Treasury published a consultation document on 20 March detailing the proposed scheme. The Government welcomes the ongoing commitment of the bank and building society sector to a scheme to allow unclaimed assets to be reinvested in society, with a focus on youth services responsive to the needs of young people, and on financial capability and inclusion. The Government plans to release a second consultation document on the distribution mechanism later in the spring.

DELIVERING A MODERN AND FAIR TAX SYSTEM

5.88 A fair and modern tax system encourages work and saving, responds to business developments and globalisation, and supports the provision of world-class public services. To ensure this, the Government will continue to develop a fair and effective tax system that provides a level playing field for all taxpayers.

²⁰ The new charity launched in May 2006 to take forward the recommendations of the Russell Commission report on youth action and engagement.

Modernising tax administration

5.89 The Government continues to work on simplifying tax administration to provide better support for compliant taxpayers, and on transforming HMRC's relationship with business. This work proceeds alongside simplification policies whose progress is described in Chapter 3.

HMRC Review of Links with Large Business **5.90** The Government's 2006 *Review of Links with Large Business*, published in November 2006, made proposals aimed at delivering a modern, responsive business tax administration to foster an environment in which business can flourish, and to improve the UK's competitiveness. **HMRC today publishes a detailed plan²¹ for delivering these proposals in consultation with business.**

5.91 The delivery plan also outlines:

- a risk-based approach to enquiries: HMRC will seek to deal with issues in real time, and reduce interventions with low-risk businesses;
- a commitment to incorporating the business perspective whenever significant changes to operational policy, legislation or administrative processes are planned;
- the statutory clearance procedures and rulings available to business, including the relevant circumstances and the necessary contact details; and
- a timetable for consultation in summer 2007 on introducing an advance rulings process and on extending existing clearance procedures to give business earlier certainty.

Treaty financing applications **5.92** The Government has agreed that HMRC can expedite its procedures for agreeing relief from UK tax on loan interests paid to non-residents, and extend the circumstances in which UK residents can enter into thin capitalisation agreements. A detailed announcement will be made later this spring.

Review of HMRC powers, deterrents and safeguards **5.93** HMRC's review of powers, deterrents and safeguards seeks to provide modern tools for the department, and corresponding safeguards for taxpayers. The next stage of consultation will focus on taxpayer safeguards, making it easier to pay, tackling late payment, and compliance assurance checks. The Government has decided not to proceed with proposals for a New Management Act at this time. Some elements of that work will be taken forward by the review of powers. Once substantive changes have been made, further simplification of tax administration will be considered.

HMRC's criminal investigation powers **5.94** Following consultation, **the Government has today announced changes to HMRC's criminal investigation powers.** Under the new approach, HMRC's investigation powers in England, Wales and Northern Ireland will be based on the Police and Criminal Evidence Act (PACE). Comparable provisions will be introduced for Scotland, where PACE does not apply.

Penalties for incorrect tax returns **5.95** In addition, **the Government has today announced a new approach to penalties for incorrect tax returns.** This will make a clear distinction between those who make a genuine mistake, who will not incur a penalty, and those who deliberately under-state their tax liability. These reforms will improve the match between taxpayer behaviour and HMRC's response. The new approach will apply to income tax, corporation tax, capital gains tax, PAYE, NICs and VAT, providing consistency of approach across these taxes.

²¹ *Making a difference: delivering the review of links with large business*, <http://www.hmrc.gov.uk>

HMRC on-line services 5.96 Following Lord Carter's *Review of On-line Services* last year, HMRC continues to invest in its on-line infrastructure. Over 35 per cent, 2.9 million in total, of self-assessment returns were submitted on-line by 31 January deadline. To encourage greater on-line filing, the deadline for filing paper returns will be brought forward to 31 October from 2008, as recommended by Lord Carter. HMRC is aiming for universal electronic delivery of business tax returns, starting with large and medium-sized employers. Following representations, **the Government today announces a more gradual introduction of requirements to file on-line to give business greater time to prepare.** Requirements for PAYE are to be introduced from 2009, VAT is now expected from 2010, and company tax returns in 2011. And, to remove the current disincentive to make payments electronically, the Government intends to change the date on which cheque payments are treated as made for corporation tax and VAT.

Modernising the tax system

5.97 The Government believes that the tax system should ensure fairness between all taxpayers and support the Government's wider economic and social objectives. Budget 2007 announces changes to the tax system to ensure that it remains modern and relevant in a changing world.

Business tax 5.98 An efficient and fair tax system is integral to fostering economic growth. **The Government is today bringing forward a package of major reforms to the corporate tax system to promote growth by enhancing international competitiveness, encouraging investment and promoting innovation.** Chapter 3 sets out full details of this package, which includes a reduction in the main corporation tax rate from 30 per cent to 28 per cent from April 2008, with accompanying reforms to the capital allowance system, R&D tax credit schemes and the small companies rate.

Capital allowances for cars 5.99 In response to business representations, **the Government is publishing a consultation update document, *Modernising tax relief for business expenditure on cars*,** outlining more detail on proposals for reforming the current system of capital allowances for cars. These proposals are aligned with the wider reform to the capital allowance system, announced today and set out in Chapter 3.

Film tax 5.100 Finance Act 2006 introduced new rules, which came into effect from 1 January 2007, for the taxation of film production companies, and in particular an additional incentive for the production of British cinema films. From Budget 2007, companies that do not want to take advantage of this incentive may elect out of the new films rules, and would then not have to comply with the administrative requirements for these rules. Such an election can apply to films starting principal photography from 1 January 2007 onwards. An election once made applies to all films produced by the company and is irrevocable.

Financial services 5.101 A competitive tax system is also vital in supporting and promoting UK financial services, in particular ensuring the ongoing pre-eminence of London as an international financial and business services centre. Chapter 3 provides more details of recent progress through the Chancellor's High-Level Group on the international competitiveness of the City of London, and of ongoing work with the fund management industry to consider the recent KPMG report, *Taxation and the competitiveness of UK funds*. Budget 2007 provides support for this strategic work through the reduction of the main rate of corporation tax from 30 per cent to 28 per cent from April 2008. In addition, the steps outlined in the following paragraphs will help to modernise, simplify and clarify taxation of financial services, and so better foster innovative development of the sector.

- Modernising tax legislation to reflect MiFID 5.102** On 20 February 2007, the Government announced action to remove obstacles to competition and expand choice in trading and reporting financial instruments, in line with the forthcoming liberalisation of financial markets through the Markets in Financial Instruments Directive (MiFID). As well as changes to enable a wider group of intermediaries to benefit from stamp duty relief, the Government is modernising the definition of recognised stock exchange²² to allow listed shares traded on markets regulated under MiFID to benefit from the tax arrangements that currently apply only to the London Stock Exchange.
- Change to the offshore funds tax regime 5.103** As announced in the 2006 Pre-Budget Report, the Government will introduce legislation in Finance Bill 2007 to remove a restriction in the offshore funds tax regime on the structure of multi-tiered funds. The Government is continuing to consult with industry on wider reform to the regime to address other tax barriers currently impacting on the development of offshore funds of funds. Subject to the outcome of consultation, the Government intends to legislate for a modernised offshore funds tax regime in Finance Bill 2008.
- Property Authorised Investment Funds 5.104** Alongside the introduction of UK-REITs (Real Estate Investment Trusts) on 1 January 2007, the Government has been continuing to consider the taxation position for Authorised Investment Funds investing in property. Following constructive discussions with industry, **the Government is today announcing a framework for taking this issue forward**, so that investors in Property Authorised Investment Funds face broadly the same tax treatment as they would have, had they owned real property or UK-REIT shares directly. Further details are available on the HM Treasury website.
- Investment Manager Exemption 5.105** **Budget 2007 announces an extension of the Investment Manager Exemption (IME) to include certain instruments for carbon trading.** The Government intends this extension to be effective from mid-April 2007. The Government is also considering responses to the recent consultation exercise on proposed changes to the Statement of Practice underpinning the IME, and will report on this at the end of March. Beyond this, the Government will continue to engage with the industry and its representatives to ensure the IME continues to attract investment management business to London.
- Islamic finance 5.106** **The Government announces today a new tax regime that enables alternatives to conventional securitisations, such as sukuk, to be issued, held and traded within the UK on the same basis as conventional securities.** In addition, HMRC is publishing guidance today on how HMRC will view alternative finance products. This includes the treatment of diminishing shared ownership arrangements, such as diminishing musharaka, for capital gains and capital allowances purposes, and how alternatives to conventional insurance, such as takaful, will fall within insurance rules. Finally, the Government encourages funders and market participants to examine ways in which Islamic finance structures can be utilised in UK-REITs and the development of Private Finance Initiative (PFI) projects.
- Taxation of insurance 5.107** The taxation of insurance remains a key issue raised during the Government's consultation with the industry through the High-Level Group and elsewhere. The policy measures, announced today and detailed below, aim to modernise the tax rules to reduce complexity and increase clarity, and have been discussed in detail with insurance industry bodies.
- General insurance 5.108** The 2006 Pre-Budget Report announced that the existing complex tax rules dealing with the reserves of general insurance companies and Lloyd's would be repealed, subject to a transitional rule, and replaced. **The detail of the transitional rules and basis for replacement accounts-based rules are now announced.** The new rules will have effect for periods of account ending on or after Royal Assent.
- 5.109** Representations have been made to the Government that the repeal of the tax rules

²² As defined from today, in Section 1005 of the Income Tax Act 2007.

dealing with general insurance reserves will impact unfairly on the sector's ability to use losses. **The Government will consult with industry on the impact of repeal of those rules.**

- Lloyd's modernisation 5.II0** Following the meeting of the Chancellor's High Level Group on 18 October, a review is underway to look at modernising Lloyd's market practice. To support this process, **the Government will consult with Lloyd's on whether existing tax rules dealing with equalisation reserves should be extended to its members.**
- Life insurance 5.III** In 2006, the Government published a consultation on certain aspects of the taxation of life insurance companies and measures were announced in PBR as an initial response. The Government welcomes the continuing dialogue that it has had with industry and, as a further response, will introduce legislation to clarify the definition and tax treatment of structural assets. In addition, **it will announce minor miscellaneous amendments to clarify and simplify the tax treatment of life companies and friendly societies. Following further consultation, the Government will bring forward legislation to replace the Crown option with new rules.**
- Insurance premium tax 5.II2** The Government is committed to ensuring business does not face undue regulatory and compliance burdens. **It today announces that it will publish a consultation document reviewing tax representative provisions of insurance premium tax.**
- Tax-motivated incorporation 5.II3** The Government remains concerned that the corporation tax system is being used to achieve a reduction of personal tax and national insurance liabilities, through the extraction of labour income as dividends. The Government considers that this has eroded the balance between providing low rates of corporation tax to encourage business investment and maintaining a tax system that is fair for all. It has therefore decided to refocus the way in which the tax system supports investment by small businesses, to provide better incentives for those businesses that reinvest their profits for growth. **Budget 2007 announces the introduction of an Annual Investment Allowance** that will provide a major cash-flow benefit to those small businesses that invest to grow their business. The Government will be increasing the Small Companies Rate to reduce the advantage of incorporation and extraction of labour income by way of dividends, providing a fairer outcome for all (further details are set out in Chapter 3).
- 5.II4** The Government will continue to monitor the level and extent to which labour income is extracted in dividends.
- Managed Service Companies 5.II5** In the 2006 Pre-Budget Report, the Government announced action to tackle Managed Service Company (MSC) schemes used to avoid paying employed levels of tax and NICs, and published a document consulting on the draft legislation. The consultation has shown widespread support for action on MSCs and the Government will be introducing legislation as planned. However, the Government is amending its approach in response to some key concerns raised in the consultation, as explained in *Tackling Managed Service Companies: summary of responses*, published today. The definition of an MSC will be strengthened to give greater clarity and certainty; the scope of the transfer of debt legislation will be clarified; and the Government will delay the application of the debt transfer legislation to third parties (other than MSC scheme providers, and directors, office holders or associates of the MSC) until 6 January 2008.
- Personal tax 5.II6** As well as fostering economic growth, an efficient and fair tax system provides fairness and transparency for individuals. The Government is today also announcing important reforms to personal taxation. These are detailed earlier on in this chapter and include: **changes to the starting and basic rates of income tax, increases in the higher rate threshold for income tax and in age-related income tax allowances, and aligning the UEL and UPL for NICs.**

Review of alignment of income tax and NICs **5.117** As announced at Budget 2006, the Government is also conducting a review of the case for further alignment of the income tax and national insurance systems.

Dividend tax credit: non-UK dividends **5.118** To simplify the tax system for UK individuals with foreign shares, **the Government will, from April 2008, extend the non-payable dividend tax credit to dividends from non-UK companies**, subject to certain conditions. A person will qualify for the non-payable dividend tax credit if they own less than a 10 per cent shareholding in a foreign company and receive less than £5,000 of non-UK dividends a year. The Government will also consider whether it is possible, without creating scope for abuse, to extend the non-payable dividend tax credit to people who do not satisfy these conditions.

Homes abroad **5.119** The Government today announced its intention to publish draft legislation later this year which will ensure that individuals owning or planning to buy a home abroad will not face a benefit-in-kind tax charge for private use, if it is owned through a company. The Government will discuss the draft legislation with interested parties to ensure that it achieves these aims.

Residence and domicile **5.120** The review of the residence and domicile rules as they affect the taxation of individuals is ongoing.

Inheritance tax **5.121** As announced at Budgets 2005 and 2006, **the inheritance tax allowance will increase to £300,000 in 2007-08, £312,000 in 2008-09 and £325,000 in 2009-10**. To continue to provide a fair and targeted system, the Government can now announce that **the inheritance tax allowance will increase to £350,000 in 2010-11**.

5.122 **Budget 2007 also introduces a change to the pre-owned assets rules** to ensure that, in certain situations, people can elect back into the IHT regime after the normal self-assessment deadline, rather than incurring the pre-owned assets charge.

Stamp duty and stamp duty land tax **5.123** **Budget 2007 announces that provision will be made in this year's Finance Bill to provide that exchanges of property between connected persons are no longer treated as linked transactions, and to make other simplifications to stamp duty and stamp duty land tax (SDLT)**.

Alcohol duty **5.124** **Budget 2007 announces that spirits duties are again frozen**, for the tenth successive Budget, meaning the total tax on a standard bottle of spirits will be £1.77 lower than if duty had risen in line with inflation since 1997; **duties on beer, wine, sparkling wine and cider will increase in line with inflation**, adding 1 penny to a pint of beer, 5 pence to a standard 75 centilitre bottle of wine, 7 pence to a 75 centilitre bottle of sparkling wine and 1 penny to a litre of cider.

5.125 It is also important that businesses are treated fairly. Currently, inconsistencies and omissions in the excise duty regimes mean that businesses may not always have the appropriate rights of review or appeal against decisions made by HMRC. The Government will consult over the summer to identify areas where the review and appeal process for excise duties can be improved.

Tobacco duty **5.126** Smoking remains the greatest cause of preventable illness and premature death in the UK. Maintaining high levels of tax helps to reduce overall tobacco consumption. **Budget 2007 therefore announces that, from 6pm on Budget day, tobacco duties will increase in line with inflation, adding 11 pence to the price of a packet of cigarettes**.

- Smoking cessation products** **5.127** Alongside the ban on smoking in public places from 1 July, and consistent with broader NHS measures to support people wishing to quit smoking, **from 1 July 2007 the rate of VAT chargeable on smoking cessation products will be reduced to 5 per cent for one year.**
- Gambling duty** **5.128** Following consultation with affected businesses, **Finance Bill 2007 will introduce a new duty of excise known as Remote Gaming Duty on the net receipts from remote gaming of all operators licensed by the Gambling Commission.** The rate of Remote Gaming Duty will be set at 15 per cent, in line with the rate of General Betting Duty.
- 5.129** **The Government today announces changes to Gaming Duty bands and rates.** These changes increase the effective rate of duty on the majority of casinos to 15 per cent, in line with the rate applied to other parts of betting and gaming, and introduce a new top rate of 50 per cent to ensure that this vibrant and expanding sector continues to make a fair contribution to tax receipts.
- 5.130** In October 2006, the Department for Culture, Media and Sport (DCMS) announced changes to the stakes and prizes of certain gaming machines. In particular, machines available in pubs and clubs saw their maximum stake rise from 30 pence to 50 pence and the maximum prize available increase from £25 to £35. Budget 2007 announces changes to align Amusement Machine Licence Duty categories with the DCMS Order, which will take effect from today.
- VAT: housing alterations for the elderly** **5.131** **The Government will, from 1 July 2007, reduce the rate of VAT for certain home adaptations that support the needs of elderly people to 5 per cent** – the lowest rate available under EU VAT agreements. This 5 per cent rate will operate alongside the existing zero rate for certain goods and services provided for disabled people.
- VAT: changes to non-business charges** **5.132** **The Government has decided to reduce to ten years the period over which businesses must account for VAT on non-business use of land and buildings.** This change, which will take effect from 1 September 2007, brings this period into line with the Capital Goods Scheme period, following the ruling by the European Court of Justice (ECJ), and reduces the scope for revenue loss through artificial avoidance schemes.
- VAT: non-alcoholic drinks** **5.133** The Government is committed to maintaining the VAT zero rate for food and drink, which saves consumers £10.5 billion every year. Consistent with this commitment and in view of developments in the non-alcoholic drinks market, the Government will explore the case for modernising and clarifying the VAT legislation, as currently applied.
- Rebated oils** **5.134** The Government's recent policy has been to maintain the differential between rebated oils and main road fuel duty rates in support of the oils fraud strategy. While the Government recognises the impact that increases can have on heavy users of rebated oils, it is also aware that the duty on rebated oils does not currently recognise the environmental costs of the fuel. In the light of these considerations, the Government will maintain the differential between rebated oils and main road fuels for 2007-08, and in the subsequent two years will increase rebated oils rates by the same proportions as main road fuels in those years. Details on incentives to encourage the use of biofuels among users of rebated gas oil are set out in Chapter 7.
- Energy Products Directive** **5.135** A number of derogations to the Energy Products Directive, which allowed the Government to charge a reduced rate of duty on fuels used in private pleasure boats and planes, and on waste oils, expired on 31 December 2006. The European Commission has to date declined to renew the majority of derogations for all member states, including the UK's derogations for private boats and planes. It has yet to respond on waste oils. **The Government will implement the changes required on 1 November 2008,** after further consultation with industry about the best way to minimise the longer-term compliance burden on the sectors concerned.

Protecting Tax revenues

5.136 The vast majority of business and individual taxpayers in the UK comply with their tax obligations and it is the Government's responsibility to ensure that they are not disadvantaged by the actions of the minority who seek to avoid paying their fair share. The Government will continue to support those who seek to be compliant while responding to non-compliance, avoidance and tax fraud with timely and targeted action. The Government will also continue to defend the tax system robustly against legal challenges under EU law.

Tackling tax avoidance 5.137 The Government will continue to tackle avoidance using legislation and litigation, while ensuring that the competitiveness of the UK is maintained. The disclosure regime, introduced at Budget 2004, allows the Government to respond to avoidance swiftly and in a targeted fashion. Following a Pre-Budget Report announcement and subsequent consultation, **the Government will introduce new powers to allow HMRC to investigate a scheme where there are reasonable grounds to believe that a promoter has failed to comply with statutory disclosure obligations.**

5.138 The Government will introduce further measures that will:

- **counter the avoidance of tax-using schemes involving life insurance policies and commission arrangements;**
- **amend the insurance premium tax definition of premium to prevent exploitation of a potential loophole;**
- **amend one of the targeted anti-avoidance rules on buying corporate capital gains and losses to ensure that it operates as intended;**
- **counter employers sidestepping provisions introduced in Finance Act 2003, in response to misuse of Employee Benefit Trusts, in order to obtain a deduction from taxable profits; and**
- **make permanent the measures introduced at the 2006 Pre-Budget Report to close known SDLT avoidance schemes.**

Life insurance companies 5.139 With effect from periods commencing on or after 1 January 2007, **the Government will simplify and strengthen the tax law relating to certain financing arrangements used by life insurance companies.**

Corporate finance 5.140 A new accounts-based regime for taxing sale and repurchase (repo) agreements for companies will be introduced to replace the current mechanical rules. The Government will consult further with business and representative bodies on the detail of the new regime. In addition, as announced on 8 March 2007, the Government will review the current rules that apply to the use of shareholder debt, that has features of equity but is treated as debt for tax purposes, in the light of market developments to ensure that existing rules are working as intended.

Loss-buying 5.141 **The Government will legislate to prevent companies buying the trading losses of corporate members of Lloyd's who are leaving the market and with whom they have no previous economic connection.**

VAT low-value consignment relief 5.142 The Government has monitored closely exploitation of the relief by companies making VAT-free supplies from outside the EU, particularly from the Channel Islands. It notes the action already taken by the authorities there to counter such exploitation. It welcomes the commitment made by the Jersey authorities, in discussions with the Government, to limit the activities of companies continuing to operate on the island, with the associated revenue loss to the Exchequer. The Government remains in discussion with the Guernsey authorities on this issue. It hopes that they will shortly be in a position to make a similar commitment. The Government will continue to keep the situation under close review.

Excise small gift relief 5.143 In light of the ECJ judgment in the Joustra case, which ruled that reliefs from duty for small, non-commercial consignments of excise goods have no basis in EC law, the Government intends to repeal the Excise Duties (Small Non-Commercial Consignments) Relief Regulations 1986.

Tackling tobacco smuggling 5.144 Following a period of consultation, the Government has reached agreement with tobacco manufacturers on the introduction of state-of-the-art pack markings that will enable HMRC and other enforcement agencies to detect counterfeit tobacco products simply and effectively. Manufacturers have agreed to introduce the new pack markings voluntarily during 2007.

Tackling alcohol fraud 5.145 In light of an increased threat from the manufacture of counterfeit alcoholic drinks in the UK and elsewhere in the EU, **the Government is announcing a package of measures to tighten up controls on the distribution of alcohol intended for industrial and other non-drinks uses.** Following consultation in 2006, in response to an increased risk of excise repayment fraud, **the Government is clarifying its guidance to tighten up the verification of claims for drawback of excise duty.**

Tackling MTIC fraud 5.146 Missing Trader Intra-Community (MTIC) fraud is an organised criminal attack on the EU VAT system. As announced in the 2006 Pre-Budget Report, HMRC's strengthened operational strategy has successfully reduced attempted fraud levels in the UK during 2006-07. The Government is determined to sustain that impact and maintain downwards pressure on the fraud. **It announced this week the introduction, with effect from 1 June 2007, of a change of VAT accounting procedure (the reverse charge) on domestic business-to-business supplies of mobile phones and computer chips.** This removes the mechanism by which fraudsters can steal VAT using those goods.

5.147 **The Government today announces that, from 1 May 2007, it will also extend the scope of the joint and several liability provisions,** which were introduced in 2003 and currently cover a narrow range of goods most commonly used by the fraudsters. These changes will allow the provisions to be applied to a wider range of specified goods. The Government will also include legislation in this year's Finance Bill to allow further changes to the joint and several liability provisions to be made by Treasury Order in the future. These changes will limit the scope for, and allow a more flexible response to any future changes in the nature of the fraud.

TACKLING GLOBAL POVERTY

5.148 Tackling global poverty remains a key priority for the Government. The Government is dedicated to ensuring that the international community delivers on the commitments it made in 2005. The UK is leading action in a number of areas to keep these promises and deliver assistance to developing country governments and their citizens. The UK is also responding to new challenges and working in innovative ways, responding to the growing environmental challenges that impact upon human development, and working with partners to launch Advance Market Commitments (AMCs) to stimulate the development of vaccines for diseases afflicting developing countries. The Government remains focused upon meeting the Millennium Development Goals (MDGs), and will continue to work with all of its partners to pursue these goals.

Delivering aid commitments 5.149 The Government's 2004 Spending Review announced that the Department for International Development's (DfID) budget would grow from £3.8 billion in 2004-05 to £5.3 billion in 2007-08. UK aid to developing countries is helping to reduce permanently the number of people living in poverty by an estimated 2 million each year. The Government is committed to a timetable of reaching Official Development Assistance of 0.7 per cent of Gross National Income by 2013. The 2007 CSR will set out the resources to 2010-11 to help meet this goal.

Debt relief 5.150 The experience of the last ten years of the Heavily Indebted Poor Countries (HIPC) Initiative has shown that debt relief can be an extremely effective tool in support of poverty reduction. Under the HIPC initiative, the debt burden of the world's poorest countries is being reduced over time by some \$100 billion, allowing the savings from debt relief to fund country-owned strategies for poverty reduction. In addition, debt relief worth \$38 billion is already being delivered under the Multilateral Debt Relief Initiative (MDRI), to the 21 countries that have completed the HIPC Initiative as a result of the cancellation of debts owed to the International Monetary Fund (IMF) and the concessional lending arms of the World Bank and the African Development Bank. Further countries will qualify on completion of HIPC. The UK is working closely with its international partners to secure the financing of Liberia's arrears to the international financial institutions, including by committing new donor resources. This will allow Liberia to benefit from debt relief through the HIPC initiative.

5.151 The UK attaches great importance to extending multilateral debt relief to all of the poorest countries, not just those countries deemed eligible under the HIPC Initiative. The UK will therefore continue to pay its share of the debt service owed to the World Bank and African Development Bank by other low-income countries that meet criteria for ensuring that the debt service savings are used for poverty reduction. The UK urges other donor countries to agree to debt relief for all low-income countries.

Education for all 5.152 Education is one of the most cost-effective investments that a country can make to support long-term development, enhancing economic growth and improving health outcomes. Every day, almost 80 million primary school-aged children are denied an education, and almost 60 per cent are girls. Many of those children who do not go to school live in fragile states and states affected by conflict. Education in the midst of conflict and in fragile states can provide an important mechanism for the registration of young children and protection against abuse, and can help states to recover from conflict.

5.153 Developing countries in Asia and Africa are preparing ambitious long-term plans to meet the education MDGs. In May 2006, 22 African countries committed to preparing ten-year plans aimed at ensuring universal primary education by 2015. 15 of these countries have now completed their plans, with five more in development. Many countries in Asia are also developing long-term plans to get all their children into school.

5.154 Long-term planning needs to go hand-in-hand with long-term predictable financing, to enable investment in schools and teaching materials, and to train teachers to deliver quality education. It is estimated that between \$7 billion and \$10 billion extra will be required each year by 2010, which corresponds to only \$10 a year, or two pence a day, for each person in the rich countries. The UK announced in 2006 that it will spend at least £8.5 billion (\$15 billion) on aid for education over the following ten years and that, for the first time, it will enter into ten-year agreements to help countries finance their education plans. **The UK has already entered into ten-year agreements with the Government of Ghana to provide £105 million, and with the Government of Mozambique to provide £150 million, in support of their ten-year education plans. The UK is providing £200 million to support India's plan to achieve universal primary education by 2010.**

5.155 The UK is providing £200 million to support India's plan to achieve universal primary education by 2010. In the run-up to a major international conference on education, which the European Commission will host in Brussels on 2 May, the UK will continue to call on donors to deliver on their promises and provide long-term predictable financing to support countries' education plans. The UK will work with donor partners, developing countries and international agencies to strengthen the delivery of education to children living in fragile states, and to children affected by conflict, as part of a coordinated humanitarian response.

- Health 5.156** Alongside education, access to basic health services is essential for developing countries to break out of the cycle of poverty and achieve economic development. Significant financing is needed to strengthen health systems and improve access to basic health services. Many of the major causes of ill health and mortality can be prevented and treated with known and affordable technologies. Stronger basic health services, supported where appropriate by innovative financing mechanisms, can transform our approach to the health MDGs.
- Health systems and services 5.157** Many developing countries face significant challenges in providing the basic health services that are essential to delivering the health-related MDGs, such as reducing child and maternal mortality. Severe under-funding, a global shortage of 4.3 million health workers and barriers to increased take-up of services, such as user fees, limit poor people's access. The UK is committed to increasing spending on basic services, such as health, within its bilateral aid programme. The UK strongly supports the priority Germany has placed in its G8 Presidency on strengthening health systems and combating HIV/AIDS. The Government will work closely with its international partners to develop these proposals. As with education, more long-term, predictable support is needed, alongside improved coordination of existing support, to help strengthen basic health services and help partner governments abolish user fees for basic health services.
- International Finance Facility for Immunisation 5.158** Worldwide, nearly 30,000 children under the age of five die every day: one child every three seconds. Around a quarter of these deaths – 2-3 million – are caused by diseases for which we have, or soon will have, a vaccine. The International Finance Facility for Immunisation (IFFIm) will dramatically expand the resources available now for immunisation by using the capital markets to convert long-term legally binding commitments from donors into upfront resources. Already \$1 billion has been raised in this way, and is helping to support a variety of programmes, including the polio eradication effort. **As part of the new investment made possible by IFFIm, the GAVI Alliance (formerly the Global Alliance for Vaccines and Immunisation) have committed to provide \$500 million over five years to finance the strengthening of basic health systems in developing countries. Ultimately, IFFIm will provide an additional \$4 billion to immunise an extra 500 million children and save 10 million lives.**
- Advance Market Commitments for vaccines 5.159** As access to existing vaccines is expanded, so too must the development of new vaccines be accelerated. 7 million children die every year from diseases like malaria, tuberculosis and AIDS where there is no effective vaccine. Yet only 10 per cent of global research and development funding is spent on such diseases. The UK will double development research funding by 2010. The Government also believes that Advance Market Commitments (AMCs) can complement this direct funding, helping to catalyse private sector investment into research and development for vaccines in developing countries. That is why the UK, along with Italy and Canada, led international efforts to establish a \$1.5 billion Advance Market Commitment for a vaccine against pneumococcal disease – the leading cause of pneumonia – which kills 1 million children every year. This pilot AMC was launched in February (see Box 5.4). The UK believes that AMCs have the potential to accelerate the discovery of vaccines against other killer diseases like malaria and AIDS.
- HIV/AIDS 5.160** The AIDS pandemic risks undermining progress towards the MDGs. The UK is strongly committed to achieving the goal – set at the 2005 G7 Finance Ministers and Gleneagles G8 Summit and confirmed by the UN in June 2006 – of universal access to comprehensive HIV prevention, treatment and care by 2010, and has pledged £1.5 billion to AIDS programmes in the two years up to 2008. Strengthening basic health systems, improving access to prevention and affordable medicines, and improving education, particularly for girls, are critical to success. The UK also supports the long-term replenishment of the Global Fund for AIDS, TB and malaria (GFATM). We are working closely with Germany, as G8 Presidency, to ensure that international action on AIDS in 2007 makes a significant contribution to the goal of universal access by 2010.

Box 5.4: Launch of Advance Market Commitment pilot

On 9 February 2007, at a ceremony in Rome attended by the Chancellor of the Exchequer Gordon Brown, Her Majesty Queen Rania Al-Abdullah of Jordan, President Wolfowitz of the World Bank, and Ministers from Canada, Italy, Malawi, Norway and Russia, the first Advance Market Commitment was launched.

The AMC is an innovative, market-based mechanism with the potential to save millions of lives by accelerating the development and production of vaccines for the world's poorest countries, vaccines that would not otherwise be available for many years. The first AMC will target pneumococcal disease, bringing potentially life-saving vaccines more quickly to 100 million children and preventing over 5 million deaths by 2030.

The AMC for pneumococcal disease will provide \$1.5 billion in future financial commitments to the poorest countries, giving them the purchasing power to buy a suitable vaccine at discounted prices when one becomes available. By creating a market for vaccines in the poorest countries, the AMC creates incentives for the pharmaceutical companies to invest in research, development and production capacity for new vaccines that serve the poor.

Canada, Italy, Norway, Russia, the UK, and the Gates Foundation made commitments to the pneumococcal AMC.

Poverty reduction through environmental protection **5.161** As the Stern Review highlights, all countries will be affected by climate change, but it is the poorest countries that will suffer earliest and most, since they are most vulnerable. Climate change is a serious long-term threat to continued growth and poverty reduction in developing countries and to reaching the MDGs. It will affect agriculture, water supplies and infrastructure, potentially resulting in reduced food security, poorer health and the increased risk of natural disasters. Alongside international action to reduce greenhouse gas emissions, support is needed to help the poorest countries adapt to climate risks, so that the changing climate does not undermine poverty reduction.

5.162 In the 2007 CSR, the Government will create a new international window of the Environmental Transformation Fund (ETF) with £800 million of official development assistance (ODA) to support development and poverty reduction through environmental protection, and help developing countries respond to climate change. This fund will be used through bilateral projects in developing countries as well as multilateral facilities such as the World and Regional Development Banks' Clean Energy Investment Frameworks. It will support adaptation and provide access to clean energy, and help tackle unsustainable deforestation.

5.163 The world's forests have extraordinary environmental, economic and cultural value, and are an essential resource for poor people: 1.2 billion people in developing countries obtain food from trees, and over 2 billion people use mainly wood for cooking and heating. Protecting these resources is a pressing development challenge. At the same time, the Stern Review highlighted that deforestation is responsible for around 18 per cent of world greenhouse gas emissions, and prompt action to tackle deforestation is a critical part of the global response to climate change. There is work underway internationally, including through the German G8 Presidency, to build long-term mechanisms to mobilise donors, countries and the carbon market in order to prevent deforestation, and the UK strongly supports the development of global partnerships on deforestation. But this is an urgent challenge, and there is a strong case for taking early action.

Box 5.5: Conservation of the Congo Forest

The Secretary of State for International Development will allocate £50 million from the international window of the UK's Environmental Transformation Fund to support proposals that have been made by ten Congo Forest countries to help them protect the Congo Basin's forests and people. The Congo Basin Forest is an essential resource providing food, shelter, and livelihoods for over 50 million people. It is the second largest tropical forest in the world and one of our most important wildernesses; but it is under increasing pressure from the unsustainable extraction of timber and other resources and from population growth. Some 1.5 million hectares of forest are lost each year and deforestation is expected to accelerate if action is not taken; a catastrophe for the 50 million people who depend on the forest, as well as for climate change and biodiversity. The UK will establish a fund that will slow the rate of deforestation by developing the capacity of people and institutions in the Congo Basin countries to manage their forests and by helping local communities find livelihoods that are consistent with the conservation of forests. The new fund will strengthen the work of the aid donors who are already active in the region, including Belgium, Canada, France, Germany, and the US, and it will open a channel for new donors to add their support.

Professor Wangari Maathai, distinguished former winner of the Nobel Peace Prize and tireless campaigner for integrating the issues of development, climate change and transparency, will lead this work. She and the UK have asked the Rt. Hon. Paul Martin; Canada's former Prime Minister and a long-standing advocate for debt relief and for African leadership in development, to help establish the fund as Goodwill Ambassador alongside Prof Maathai. They will advise on the Fund's governance and how the work is implemented, helping to develop a clear governance framework designed to ensure that it has strong African ownership and supports the needs of the Congo Basin's countries, that it protects the livelihoods and rights of forest people, and that it is spent effectively, with good financial management free from corruption.

5.164 The UK is providing assistance to the World Bank and the Regional Development Banks to develop a Clean Energy Investment Framework to accelerate public and private investment in low carbon energy in developing countries. To promote adaptation, the UK is already providing £5 million towards the expected total cost of £36 million for the ClimDev Africa Program, previously known as the Global Climate Observing System, to improve climate data for development in Africa. To increase climate change research the UK has initiated a £30 million programme (in collaboration with the Canadian International Development Research Centre) to build and maintain the capacity and knowledge of African researchers. The UK is committed to mainstreaming climate risk reduction and is working with the World Bank to put measures in place for screening development assistance by 2008. The UK is committed to giving a higher priority to disaster risk reduction, through allocating 10 per cent of the funding provided in response to each natural disaster to prepare for and mitigate the impact of future disasters.

Trade 5.165 Trade can, under the right circumstances, be a driver of economic growth, development and poverty reduction, benefiting developed and developing countries alike, provided they have the economic infrastructure and capacity to trade competitively. In the face of a current rise in protectionist sentiment, urgent reform of the global trading system is needed. The UK is delighted that, following the suspension of negotiations in the Doha Round of world trade talks last July, full negotiations have now resumed. The UK continues to do all it can to achieve a conclusion to the negotiations at the earliest opportunity. For the talks to conclude successfully, all key World Trade Organisation (WTO) players will need to play their part and deliver increased market access in agriculture, industrial goods and services; end

export subsidies; substantially reduce all trade-distorting domestic support; and provide effective special and differential treatment to enable developing countries to capture the gains from trade. Developing countries must also have the flexibility to design, plan and sequence trade reforms in line with their country-owned development and poverty reduction strategies.

Aid for trade 5.166 Efforts to increase market access and phase out subsidies will only generate a limited supply-side response from poorer countries unless they are complemented by the necessary investments to boost their capacity to trade, and to help them participate effectively and fairly in the global trading system. This is also critical in building support for open markets. Before the WTO ministerial in Hong Kong in December 2005, developed countries made 'aid for trade' pledges and agreed to prioritise investments in infrastructure. At the annual meetings of the IMF and the World Bank in Singapore in September 2006, the UK announced that its support for 'aid for trade', which includes training trade specialists and building trade institutions, as well as support for infrastructure – such as roads, ports, and telecommunications – is expected to increase by 50 per cent by 2010-11. This will equate to \$750 million a year in 2010.

5.167 Together, European countries and the European Commission will increase assistance to a total of €2 billion a year by 2010. Japan has also promised \$10 billion over three years and the US a total of \$2.7 billion a year by 2010. The UK calls for all countries to turn their commitments into concrete and credible financing, starting by making the enhanced Integrated Framework operational as soon as possible.