5 BUILDING A FAIRER SOCIETY

The Government is committed to promoting fairness alongside enterprise so that everyone can take advantage of opportunities to achieve their full potential in an outward-looking, flexible economy. The reforms of the welfare state introduced by the Government since 1997 reflect its aims of eradicating child poverty, supporting parents to balance their work and family life, promoting saving and ensuring security for all in old age. The Government is also committed to a modern and fair tax and benefit system which encourages work and saving and ensures that everyone pays their fair share of tax. This Pre-Budget Report sets out the next steps the Government is taking to support these aims, including:

- **a ten-year strategy for childcare**, setting out the Government's long-term vision of affordable, flexible, high-quality childcare for all parents who need it, and providing parents with real choices in balancing work and family life;
- **an extension of paid maternity leave from six months to nine months from April 2007**;
- **an increase in the entitlement to free nursery education for all 3 and 4 year olds** to 15 hours a week for 38 weeks a year, reaching all children by 2010;
- **improvements to the childcare element of the Working Tax Credit,** with an increase in the maximum eligible costs to £175 a week for one child and to £300 a week for families with two or more children from April 2005, and an increase in the maximum proportion of costs covered from 70 to 80 per cent from April 2006;
- **further steps to encourage saving and asset ownership**, through ISAs, the Saving Gateway and Stakeholder products;
- **consultation on the value of payments at age seven in the Child Trust Fund;**
- **a package of measures to promote financial inclusion**, by increasing access to banking services, affordable credit and face-to-face money advice;
- **a £50 payment to households with someone over age 70 in addition to the Winter Fuel Payment in 2005**, to help meet the cost of council tax and other living expenses;
- **action to protect tax revenues and modernise the tax system**, including measures to combat tax fraud and avoidance; and
- **the development priorities for the Presidencies of the G7/8**, and further steps to tackle global poverty and reduce developing country debt.

5.1 The Government's aim is to build a strong economy and a fair society, where there is opportunity and security for all. The Government is committed to ensuring that flexibility and fairness are advanced together, so everyone can achieve their full potential in a modern, dynamic economy.

5.2 In an increasingly competitive and integrated global economy, the pace of economic change will be ever quicker and more intense. This has great potential benefits in terms of growth and prosperity. Policies that ensure fairness are important to minimise the short-term consequences that can be associated with economic change.

5.3 Chapter 4 describes the Government's reforms to promote employment opportunity for all and to provide support to help people back into the labour market. This chapter describes the action the Government is taking to provide security for all, with more help for those who need it most, when they need it most. It sets out the progress the Government has made in a number of areas, including tackling child poverty and improving childcare to ensure that all children have the opportunity to fulfil their potential; promoting saving and asset ownership to provide security and enhance opportunity; and tackling pensioner poverty and ensuring security for all in old age. The Government is also committed to creating a modern and fair tax system, which adapts to changes in business and the global economy and ensures everyone pays their fair share toward building world-class public services.

5.4 Building on the progress that has been made in these areas, the Pre-Budget Report sets out new action the Government is taking to meet the long-term economic challenges facing the UK, including:

- a ten year strategy for childcare, setting out how the Government will support families in achieving the balance between work and family life that best suits them and their children. Access to affordable, flexible, high-quality childcare is key to tackling deprivation, removing barriers to parents' employment, and supporting children's long-term educational development, helping to provide the educated and highly-skilled workforce that the UK needs to prosper in the global economy; and
- measures to promote saving and asset ownership and ensure security for all in old age. Investment in assets, savings and pensions provides long-term independence and opportunity, and insurance against unforeseen events, allowing individuals the flexibility to adjust to changing economic circumstances.

5.5 The Government is also committed to tackling global poverty and achieving the Millennium Development Goals. This chapter describes the action the Government is taking to push for increased international resources for development and to widen and deepen debt relief for poorer countries. It also sets out the Government's development priorities for the UK's Presidencies of the G7/8 and the EU in 2005.

SUPPORT FOR FAMILIES AND CHILDREN

Eradicating child poverty

5.6 Tackling child poverty will both improve individuals' life chances and contribute to the development of an educated and highly-skilled workforce. The Government has an ambitious, long-term goal to eradicate child poverty by 2020. The Government's strategy is to provide financial support for families, with work for those who can and support for those who cannot; and to deliver high quality public services, which are key to improving poor children's life chances and breaking cycles of deprivation.

Progress to date

5.7 Significant progress has already been made in reversing the long-term trend of rising child poverty. By the mid 1990s, the UK suffered higher child poverty than nearly all other industrialised nations. However, as a result of investment in financial support for families and rising employment, the Government is on course to meet its Public Service Agreement (PSA) target to reduce the number of children in relative low-income households by a quarter between 1998-99 and 2004-05. The most recent data shows that by 2002-03, the numbers of children in relative low-income households had fallen by 0.5 million before housing costs (BHC) and by 0.6 million after housing costs (AHC), from 3.1 million and 4.2 million respectively. Over the same period, the number of children in absolute low-income households fell from 2.8 million to 1.5 million BHC and 4.0 million to 2.2 million AHC.[1]

[1] Data from *Households Below Average Income 1994-95 to 2002-03*, Department for Work and Pensions, 2004.

New child poverty target

5.8 Working towards the eradication of child poverty, the 2004 Spending Review announced a new PSA target to halve the number of children in relative low-income households between 1998-99 and 2010-11.[2] The Government will also set an additional target in the 2006 Spending Review to halve by 2010-11 the number of children suffering from both material deprivation and relative low income.

Delivering the new child poverty target

5.9 Building on progress to date, the Government is committed to providing more help for parents to work and guaranteeing affordable, good quality childcare for those who need it. It also has a long-term aspiration to improve financial support for large families. To reduce material deprivation the Government is increasing the availability of decent housing and tackling financial exclusion. Through measures such as improving early years services, raising standards in schools, tackling health inequalities and providing extra help for families at risk, the Government aims to improve the life chances of poor children. This approach was set out in the Treasury's recent Child Poverty Review.[3]

Child poverty accord

5.10 The Government will work closely with partner organisations as it develops policy across welfare reform and public services. In particular, central government and the Local Government Association have established a new 'child poverty accord' to enhance effective collaboration in tackling child poverty.[4]

Financial support for families with children

5.11 Since 1997 the Government has radically reformed the way it provides support to families with children, driven by two principal objectives:

- to support all families with children, recognising the benefit of a good start in life and that families with children face additional costs; and
- to deliver progress on its ambitious goal to eradicate child poverty, by offering greatest support to those most in need, while maintaining incentives to work.

5.12 This model of progressive universalism is delivered through a combination of Child Tax Credit (CTC), which was introduced together with the Working Tax Credit (WTC) in April 2003, and Child Benefit. Tax credits are benefiting 6.1 million families and 10.5 million children, including those families receiving their child allowances through their benefits. Tax credits are reaching far more low and moderate-income families than any previous system of income-related financial support.

Increased support for families

5.13 **This Pre-Budget Report announces that from April 2005 the child element of CTC will increase by £65 to £1,690 a year**, meeting the Government's commitment to increase it in line with average earnings. This means that the annual amount of the child element of CTC will have increased by £245 since its introduction in April 2003. A family with two young children and a full-time earner on £15,400 per year, half male average earnings, will receive over £103 per week in CTC and Child Benefit next year, a real terms increase of 85 per cent since 1997-98. Table 5.1 shows the levels of support that CTC and Child Benefit will provide for families from April 2005. Annex B provides further details of the changes to the rates and allowances within the tax and benefit system announced in this Pre-Budget Report.

[2] In line with international practice, low income will be measured on a BHC basis. The Government continues to monitor progress against a range of other indicators, including income measured on an AHC basis and data on regional variations in child poverty.

[3] *Child Poverty Review*, HM Treasury, July 2004.

[4] Available at www.hm-treasury.gov.uk.

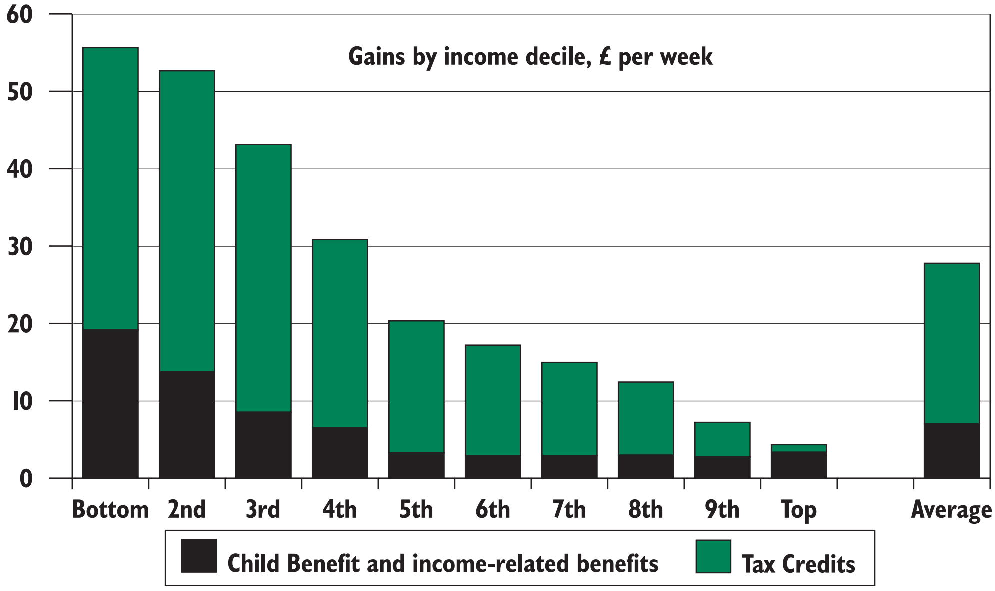
Table 5.1: Annual levels of support for families from April 2005

Family income (£ a year)	less than £13,910	less than £50,000	all families
Per cent of families	*30*	*82*	*100*
1 child	£3,125	£1,430	£880
2 children	£5,410	£2,020	£1,475
3 children	£7,695	£2,615	£2,065

5.14 Chart 5.1 shows the impact by income decile on families with children of the Government's reforms to the tax and benefit system since 1997. As a result, by April 2005, in real terms:

- families with children will be, on average, £1,300 per year better off, while those in the poorest fifth of the population will be, on average, £3,000 per year better off;
- a single-earner family on half average male earnings with two children will be £3,700 a year better off; and
- a single-earner family on average male earnings with two young children will be £255 a year better off.

Chart 5.1: Gains for families as a result of tax credits and other children's measures by 2005



Source: HM Treasury.

5.15 A range of Government policies aim to make utility bills more affordable for low-income and vulnerable customers by improving energy efficiency, tackling fuel poverty and providing financial support with fuel bills. The Fuel Poverty Action Plan, published in November 2004, sets out how the Government is working to tackle fuel poverty and extend the Warm Front scheme. Cold Weather Payments provide extra help with heating costs to vulnerable people during periods of very cold weather in their local area and households with someone aged over 60 receive Winter Fuel Payments. Further details on measures to support pensioner households are set out later in this chapter. The Department for Environment, Food and Rural Affairs is today publishing a report on water affordability.

Choice for parents, the best start for children: a ten year strategy for childcare

5.16 Good quality, affordable childcare and early education is central to several of the Government's long-term objectives: improving outcomes for children and helping parents move into work and training. The Government has invested heavily in childcare and early years support, creating 1.2 million new childcare places in England since 1997. Despite this progress, some parents are still not able to find the childcare that they need.

5.17 The Government is publishing *Choice for parents, the best start for children: a ten year strategy for childcare* alongside this Pre-Budget Report, setting out its long-term vision to ensure that every child gets the best start in life and to give parents more choice about how to balance work and family life.[1]

Choice and flexibility

5.18 The Government will ensure parents have greater choice in balancing work and family life, through:

- a goal of **twelve months paid maternity leave by the end of the next Parliament**. As a first step this Pre-Budget Report announces the extension of the entitlement to nine months from April 2007;
- **legislation to give mothers the right to transfer a proportion of this paid leave to the child's father by the end of the next Parliament**;
- **an increase in the flat rate of Statutory Maternity Pay, Maternity Allowance and Statutory Adoption Pay and Statutory Paternity Pay to £106 a week from April 2005. The Government is committed to increasing the flat rate over time** in the light of evidence on take-up of pay and leave rights;
- committing to consulting with employers, unions and other stakeholders, for extending the case for **extending the right to request flexible working to the parents of older children and carers of sick and disabled relatives**; and
- **giving every family easy access to integrated services through Children's Centres** in their local community, offering information, health, family support, childcare and other services for parents and children. 2,500 Children's Centres will be in place by 2008 and 3,500 by 2010.

Availability

5.19 The Government's vision is that **all families with children aged up to 14 who need it can find an affordable, flexible, high quality childcare place that meets their circumstances.** This will be achieved through:

- **legislation for a new duty on local authorities in place by 2008 so that over time they will secure sufficient supply** to meet the needs of families;
- **a goal of 20 hours a week of free high quality care for 38 weeks for all 3 and 4 year olds** with this Pre-Budget Report announcing **a first step of 15 hours a week for 38 weeks a year reaching all children by 2010**; and
- **an out of school childcare place for all children aged 3-14 between the hours of 8am to 6pm each weekday by 2010.**

[1] *Choice for parents, the best start for children; a ten year strategy for childcare*, HM Treasury, December 2004.

Quality 5.20 The Government is committed to high quality childcare provision with a highly skilled childcare and early years workforce that is among the best in the world, by:

- **ensuring all full daycare settings are professionally led;**
- **creating a Transformation Fund worth £125 million each year from April 2006** to invest in high quality, sustainable, affordable provision;
- **radically reforming the workforce, with the Children's Workforce Development Council consulting on a new qualification and career structure in 2005;** and
- **reforming the regulation and inspection regime** to improve standards and to give parents better information.

Affordability 5.21 The Government wants families to be able to afford flexible, high quality childcare that is appropriate for their needs. This Pre-Budget Report takes further steps to ensuring this by:

- **increasing the limits of the childcare element of the Working Tax Credit to £300 a week (£175 for one child) from April 2005, and an increase in the maximum proportion of costs that can be claimed from 70 per cent to 80 per cent from April 2006.** The definition of eligible childcare and the maximum eligible costs in Housing Benefit and Council Tax Benefit will be aligned with the childcare element of WTC. For a couple family on £34,000 a year with both parents working and typical childcare costs for two young children, these reforms reduce the proportion of childcare costs they pay from 85 per cent to 75 per cent, a saving to them of £700 per year. Building on this first step, the Government's long-term ambition is to reduce further the proportion of childcare costs paid by such families, making childcare increasingly affordable;
- announcing **£5 million from April 2006 for a pilot to work with the Greater London Authority** to address childcare affordability issues in London;
- extending the range of quality childcare that is eligible for financial support, by introducing **a childcare approval scheme for England, to complement existing registered childcare, which will be in operation by April 2005**. Further details of the scheme will be announced later this month by the Department for Education and Skills (DfES); and
- extending support for employer-supported childcare. **The Government announced in the 2003 Pre-Budget Report that from April 2005 where an employer offers childcare vouchers or childcare provision the first £50 a week will be free of tax and National Insurance contributions.** This exemption is subject to the benefit being offered to all employees and for childcare that is registered or approved. The £50 a week exemption applies to the cost to the employer of providing the childcare benefit. For childcare vouchers, this cost is normally the face value of the voucher plus associated administration charges. **This Pre-Budget report announces that from April 2005 the £50 a week limit will apply to the face value of childcare vouchers and that associated administration costs and service charges will also be exempt from tax and NICs.**

SUPPORTING YOUNG PEOPLE

5.22 *Skills in the global economy*,[2] published alongside the Pre-Budget Report and described in Chapter 3, sets out both the Government's ambition for enhancing skills and new long-term proposals to build on ongoing success in this area. Enhancing skills is an increasingly important long-term economic challenge for developed countries. For an individual, skills provide security and opportunity. Better qualified people are more likely to be in work, to be supported by their employers to improve their skills, and to be paid more. More widely, skills provide personal fulfilment and can enable people to contribute to their communities. The Government's aspiration is for all young people to continue in learning after the age of 16.

Financial support for young people

5.23 The national roll out of Education Maintenance Allowances (EMAs), described in Chapter 3, will raise the participation rate of young people in full-time education. The success of EMAs points to the importance of financial support and incentives in delivering higher rates of post-16 participation. Published alongside Budget 2004, *Supporting young people to achieve*[3] reviewed the system of financial support for 16-19 year olds. The report set out a package of short-term measures and a long-term vision to improve financial support for 16-19s, with the aim of increasing post-16 participation in learning. The Government is currently considering over 50 responses from individuals and organisations to its consultation on the long-term vision of financial support for 16-19s and will respond in Budget 2005.

Extending financial support for 16-19s

5.24 As an important, initial step towards its long-term vision, the Government will shortly publish the first Child Benefit Bill since 1975, for introduction in the current session of Parliament. The Bill will enable the extension of Child Benefit to unwaged trainees and 19 year olds completing their course. In consultation with external stakeholders, and subject to developments in Apprenticeship policy, the Government is considering extending Child Benefit to unwaged trainees in Government approved training. Alongside improvements to financial support for young people in learning, and to simplify the current system, the Government is also considering increasing support to 16-17 year olds on Income Support and Jobseeker's Allowance.

FAIRNESS FOR DISABLED PEOPLE

5.25 The Government is determined to advance the rights of and opportunities for disabled people, and ensure their full participation in society. Chapter 4 sets out the steps the Government is taking to increase employment and financial support for people with a health condition or disability who want and are able to work. The Government also continues to tackle discrimination in the workplace and beyond, and to provide support for those unable to work.

5.26 Since 1997, the Government has extended and improved the protection that the Disability Discrimination Act offers to disabled people. Since October 2004, duties on employers not to discriminate against disabled people have applied to employers with fewer than 15 employees, and to previously exempt occupations. This brings an additional one million employers and seven million jobs within the scope of the employment provisions of the Act. The Act also now requires all service providers to make reasonable adjustments, including to physical features of premises, to make services more accessible to disabled people. The Disability Discrimination Bill will provide protection to 175,000 more people with HIV, cancer and MS, and place a duty on public bodies to promote equality of opportunity for disabled people.

[2] *Skills in the global economy*, HM Treasury, December 2004.

[3] *Supporting young people to achieve: towards a new deal for skills*, HM Treasury, DfES and DWP, March 2004.

5.27 From April 2005, the disabled child element in the CTC will provide a supplement of up to £2,285 a year for each disabled child and a further £920 a year for each severely disabled child. The disabled child premium has increased by 70 per cent in real terms compared with the equivalent support offered in 1997. 110,000 working families were benefiting from the disabled child element of the CTC by July 2004; over three times higher than the number who benefited from the disabled child credits under the previous tax credit system.

PROMOTING SAVING, ASSET OWNERSHIP AND INCLUSION

5.28 Assets and savings provide opportunity and independence throughout life, flexibility to adjust to unforeseen events and financial security in retirement. Based on the principle of progressive universalism, the Government seeks to make asset ownership accessible to all, while providing more help for those who need it most.

5.29 Building on the platform of macroeconomic stability set out in Chapter 2, which provides an environment conducive to long-term planning, the Government seeks to provide targeted support and incentives for saving from childhood, through working life and into retirement. Set out in detail later in this section, the Pre-Budget Report announces action to further promote saving and asset ownership in three areas:

- *Individual Savings Accounts* – which provide accessible, tax-free savings;
- *the Saving Gateway* – which is piloting the provision of a Government cash contribution to 'match' individual savings for those on low incomes; and
- *Stakeholder savings and investment products* – simple, low-cost and risk-controlled, with a charge cap that protects consumers from high charges.

5.30 The Government is also introducing the Child Trust Fund, which will ensure assets for all children, promote positive attitudes to saving and improve financial capability.

5.31 The Government is also committed to promoting financial inclusion to ensure that everyone can access the financial services and products that they need to manage their finances, avoid high cost credit and start to save. Discussed later in this chapter, *Promoting Financial Inclusion*,[4] published alongside this Pre-Budget Report, sets out the Government's proposals to tackle financial exclusion.

Saving decisions

5.32 It is vital that saving and asset-building decisions are better understood. Individuals' saving preferences vary over their lifetimes and cover a variety of assets, from savings stamps, deposit accounts, pensions, stocks and shares, to homes and businesses. The Government is committed to a policy framework that enables people to choose how and when to save across the full range of asset-building activities. Traditional measures of aggregate saving, such as the saving ratio, often fail both to reflect this variety and to highlight the positive impact asset growth has had on households' balance sheets in recent years. Broader measures, for example including capital growth, indicate that saving behaviour has been more robust in recent years than is often appreciated.[5]

[4] *Promoting Financial Inclusion*, HM Treasury, December 2004.

[5] See, for example: Bank of England, *Quarterly Bulletin*, Spring 2001; New Zealand Treasury, *Household Net Wealth: An International Comparison*, 2001; and Federal Reserve Bank of New York, *Current Issues in Economics and Finance*, September 2000.

5.33 Total household assets – including savings, pensions, life insurance and housing – stand at around £6 trillion. This greatly outweighs total household debt, the build up of which, at the aggregate level, has been primarily associated with asset accumulation, particularly housing, rather than with borrowing to fund current consumption.[6] Overall, household net wealth has grown by around 50 per cent in real terms since 1997. Nevertheless, the Government recognises that some households face acute problems of over-indebtedness. In response, the Government set out in July 2004 its strategy for tackling over-indebtedness.[7]

5.34 Tax incentives can encourage people to save and the Government already facilitates a wide range of tax-favoured saving and investment vehicles. ISAs and National Savings & Investment products, including Premium Bonds, offer a range of tax-advantaged savings opportunities and many savers benefit from the lower 20 pence rate of tax on savings income. These measures are supported by around £2 billion in tax relief every year. Further opportunities exist to invest tax-free in Venture Capital Trusts and Enterprise Investment Schemes, many employees have access to tax-free share option schemes and incentive plans and individuals automatically receive exemption from Capital Gains Tax on investment profits up to an annual limit of £8,200. Taken together, these opportunities are supported by a further £2 billion in tax relief every year. The Government also recognises that not all households are able to take advantages of these opportunities, and that a significant minority hold few or no savings or assets. The Government is committed to providing them with additional support, as access to even small amounts of savings can help to provide security and insulation from adverse shocks.

Promoting saving and asset ownership

Individual Savings Accounts

5.35 Over 16 million people now have an Individual Savings Account (ISA), with over £150 billion subscribed since 1999. ISAs have reached a wider section of the population than TESSAs (Tax Exempt Special Savings Accounts) or PEPs (Personal Equity Plans), which they replaced, with increased take-up among both low-income groups and the young. These savings are supported by around £1.6 billion in tax relief every year.

5.36 When ISAs were introduced in 1999 they were guaranteed to run for ten years to 2009, and the overall annual investment limit was set at £5,000, with a maximum of £1,000 in cash. A higher initial limit of £7,000, with a maximum of £3,000 in cash, was set for the first year to encourage new saving. In 2000, this higher limit was extended to April 2006. **The Government remains committed to ISAs and plans, subject to consultation, to further extend the existing higher ISA limits to 2009.** The Government would welcome views and evidence on this proposal from industry, consumer groups and others. For someone saving the maximum each year this would permit £70,000 in tax-relieved savings over ten years, well above the £50,000 orginally promised.

Matching and the Saving Gateway

5.37 In addition to using tax incentives to encourage saving, the Government can support saving through 'matching', by providing a cash contribution to individual savings. Matching provides: a more understandable, transparent and effective framework of support for savers; and greater incentives for those on low incomes who often cannot benefit from tax relief. Matching has been used since 2001 in the 'relief at source' scheme for personal and stakeholder pensions and is being piloted for low-income groups in the Saving Gateway.

[6] Further detail on the household balance sheet is set out in Annex A.

[7] *Tackling Over-Indebtedness: Action Plan 2004*, Department for Trade and Industry, July 2004.

5.38 The Saving Gateway is designed as an ideal starting point for individuals who would otherwise have difficulty getting on to the savings ladder. Under the pilot scheme established by the Government in 2002 and run by the Halifax bank, the Government matched pound-for-pound the savings of low-income households up to a limit. The Community and Finance Learning Initiative, run by DfES, provided tailored financial information and education alongside the Saving Gateway accounts to help individuals make informed saving decisions.

5.39 The pilot schemes have all now matured and the full evaluation of the pilot will follow in early 2005. The interim evaluation finds that matching can provide an important new dimension to Government support for saving.[8] **Therefore, the Government will launch a larger, £15 million Saving Gateway pilot in 2005.** The new pilot will investigate alternative rates of matching, measure the impact of matching for a wider range of income groups and, working with DfES, will use the support of a wider range of community financial education bodies. Evidence gathered through this pilot will be used to evaluate the future role matching could play in Government support for savings, both for those on low incomes and more generally. As set out in the Pensions Green Paper, the Government will also look to illustrate the generous matching top-up that tax relief on individuals' pension contributions provides.

Stakeholder savings and investment products

5.40 Following the Sandler review[9] of the retail savings industry, the Government announced in July 2003 the specifications of the new 'Stakeholder' suite of simple, low-cost, risk-controlled savings and investment products. This suite will include Stakeholder pensions. The new Child Trust Fund will also have a Stakeholder option. A key feature of the product suite is a charge cap that will protect consumers from high charges, while providing firms with the opportunity to sell these products viably. In June 2004, the Government announced that a charge cap of 1.5 per cent per year would apply to the medium-term and pension products for the first 10 years that an investor holds a product; thereafter a cap of 1 per cent will apply. The Government will review the charge caps in 2008.

5.41 In November 2004, the Treasury introduced legislation to create the full range of products for the Stakeholder suite, and DWP launched a consultation on amendments to the Stakeholder pension. To reduce the cost of distributing these products, the FSA introduced regulations on the basic advice process through which Stakeholder products may be distributed, which will be implemented in April 2005. The Government will continue to consult with industry and consumer groups on the most effective way to market these products.

Child Trust Fund

5.42 In recognition of the role that assets play in creating opportunity, independence and security, the Government is pioneering a universal, progressive, asset-based welfare policy. The Child Trust Fund, to be launched in April 2005, will be at the heart of this new strand of welfare policy. It aims to ensure assets for all children, promote positive attitudes to saving and improve financial capability. It will build on financial education by providing a long-term savings and investment account with which children can engage, raising their confidence as they use the account and deal with financial providers.

[8] *Evaluation of the CFLI and Saving Gateway Pilot Projects*, University of Bristol, Personal Finance Research Centre, October 2003.

[9] *Medium and Long-term Retail Savings in the UK: A Review*, Ron Sandler, July 2002.

5.43 To help children start saving, all those born since September 2002 will receive at least £250 to invest in a long-term Child Trust Fund account; children from families on lower incomes will receive £500, in line with the Government's principle of progressive universalism. To encourage the saving habit, children, parents, family and friends will between them be able to contribute up to £1,200 a year to each account and there will be no tax to pay on any interest or gains made on this money. Box 5.1 outlines the process for introducing the Child Trust Fund. The Child Trust Fund will also help tackle financial exclusion, since all children will automatically have access to financial services.

5.44 The Government has committed to make a further payment at age seven into all Child Trust Fund accounts. This payment will be progressive, like the initial endowment, as the Government believes that poorer children should receive more help. **The Government will now consult on a further universal payment of £250 at age seven, with children from low-income families receiving £500.**

Box 5.1: The Child Trust Fund: countdown to introduction

15 November 2004 **– Child Trust Fund website (www.childtrustfund.gov.uk) launched and Child Trust Fund Helpline opened (0845 302 1470).**

15 November to December 2004 **– The Government is writing to all families of eligible children to advise them that the Child Trust Fund is being introduced in April 2005 and to let them know that they will not need to make a separate claim for a Child Trust Fund account.**

17 January 2005 **– The Government will begin automatically sending out Child Trust Fund information packs and vouchers to all parents of children born since September 2002. Parents can use the voucher to open an account of their choice with a participating financial provider.**

17 January 2005 **– A major advertising campaign will start to raise awareness of the Child Trust Fund. This will ensure that parents understand what they need to do and encourage them to make an active choice of account.**

6 April 2005 **– Child Trust Fund accounts will become fully operational. After this date, Government funds will go into the account, and family and friends can start contributing.**

6 April 2005 onwards **– Information packs and vouchers will be sent automatically to parents of children once they have been awarded Child Benefit for their child.**

Promoting financial inclusion

5.45 Access to mainstream financial services is restricted for many people on low incomes. This imposes costs on those who can least afford them and prevents individuals from getting started on the savings ladder. Since 1999, the Government has sought to tackle financial exclusion, including working in partnership with banks to develop basic bank accounts and the Post Office Card Account, to which the banks have made a valuable contribution of £182 million. Despite these developments, financial exclusion remains a problem for millions of households. In 2002-03 there were about 2.8 million adults in households with no access to a bank account. Over one million basic bank accounts have been opened since 2003 and the banking industry has announced a welcome change to the Banking Code to make basic bank accounts more available for those who want them.

5.46 *Promoting Financial Inclusion,*[10] published today alongside the Pre-Budget Report, sets out proposals to tackle financial exclusion, including a £120 million Financial Inclusion Fund to support initiatives to tackle financial exclusion over the next three years. Brian Pomeroy, former Chairman of the National Lottery Commission, will chair a new Financial Inclusion Taskforce, to oversee progress on tackling financial exclusion.

Access to banking

5.47 The banks and the Government share the aim of reducing financial exclusion. **They have agreed to work together towards the goal of halving the number of adults in households without a bank account, and of having made significant progress in that direction within two years.** Developments will be reviewed at the end of the two-year period to see if further initiatives are needed.

Access to affordable credit

5.48 Many low-income households rely on the 'alternative credit market', where typical products have Annual Percentage Rates (APRs) of over 100 per cent, many times the APRs of standard mainstream products. The Government has been working to identify creative solutions to reducing the cost of lending and increasing access to affordable credit, building on existing good practice. **The Government is considering mechanisms whereby, in certain circumstances, private and 'third' sector lenders could apply for repayment to be made by deduction from benefit where normal repayment arrangements have broken down**, in order to boost the ability of private, voluntary and community sector partners to offer affordable loans to those on the lowest incomes.

5.49 Not-for-profit or 'third' sector lenders such as credit unions and Community Development Finance Institutions (CDFIs) have a key role to play in the provision of affordable credit to those on low incomes. ***Promoting Financial Inclusion* sets out a range of measures the Government will put in place to boost the coverage, capacity and sustainability of the sector in providing affordable loans to the financially excluded.**

Access to money advice

5.50 The Government recognises that face-to-face money advice provision is a particularly effective mechanism in tackling over-indebtedness for more vulnerable consumers. *Promoting Financial Inclusion* sets out how **the Financial Inclusion Fund will support an increase in the capacity of the face-to-face money advice sector, and pilot models of money advice outreach aimed at those who do not normally present themselves to debt advisers**.

Financial capability

5.51 The Government is also supporting wider efforts to improve financial capability. In 2001, personal finance education was introduced in schools as a non-statutory part of the national curriculum in England. The Government is now examining the scope to develop the subject and to better support teachers. In addition, the FSA is currently working with a range of parties to develop a national strategy for financial capability, focused on increasing capability across key the population at key life stages. This strategy is a critical platform to ensure that financial capability, particularly for the excluded, is built effectively.

The Social Fund

5.52 The Social Fund provides a safety net of grants and loans for the most vulnerable in times of crisis. The 2004 Spending Review announced the intention to abolish the 'double debt' rule in the Budgeting Loans scheme, which takes an applicant's outstanding Budgeting Loan debt into account twice in calculating the maximum amount he or she can borrow. The Government also announced the intention to lower the highest loan repayment rates. This means that the current 15 per cent repayment rate will be lowered to 12 per cent of a claimant's benefits. **This Pre-Budget Report announces that these reforms will be implemented in April 2006**. These measures, which amount to an increase in funding for the Social Fund of £210m over the three years to 2008-09, will enable the Social Fund to play a more effective role in helping those families most vulnerable to over-indebtedness. The Government is continuing to consider further reform of the Social Fund in the wider context of its vision for greater financial inclusion.

[10] *Promoting Financial Inclusion*, HM Treasury, December 2004.

Treatment of capital limits

5.53 The Government is committed to removing disincentives for those on lower incomes to save. It will keep under review the treatment of savings in income-related working age benefits, so as not to penalise saving unfairly. **As announced in Budget 2004, from April 2006, the threshold above which savings begin to reduce eligibility for Income Support, Jobseeker's Allowance, Housing Benefit and Council Tax Benefit will be raised from £3,000 to £6,000.**

FAIRNESS FOR PENSIONERS

5.54 A fair society guarantees security in old age and ensures that all pensioners can share in rising national prosperity. The Government launched the Pension Credit in 2003 to tackle pensioner poverty and reward saving. It has also launched a programme of informed choice to empower individuals to make their own decisions about working and saving for retirement. The Pensions Commission's recent report[11] explains that, in common with most developed countries, the UK faces a number of challenges in enabling individuals to meet their aspirations for retirement incomes in an ageing society.

Fairness for today's pensioners

5.55 Building on the foundation of support for retirement income provided by the basic and additional state pensions, the Government continues to focus resources on the poorest pensioners. From 2005-06 the poorest need not live on an income below £109.45; in 1997 this figure was £69. The successful launch of Pension Credit in October 2003 builds on this, further extending support to the poorest pensioners and rewarding those who have built up small savings for retirement as described in Box 5.2.

Security for today's pensioners

5.56 The Government is continuing to guarantee pensioners' security and tackle pensioner poverty by:

- guaranteeing that the April increase in the basic state pension will be in line with the Retail Price Index for the previous September or 2.5% (whichever is higher), meaning that the basic state pension will rise to £82.05 for single pensioners and £131.20 for couples from April 2005;
- increasing the guarantee element of Pension Credit in line with earnings to £109.45 for single pensioners and £167.05 for couples from April 2005; and
- increasing the Pension Credit savings reward to a maximum of £16.44 a week for single pensioners and £21.51 for couples.

5.57 This is in addition to existing measures, which provide:

- a Winter Fuel Payment of £200 per household for those over 60 rising to £300 for households with someone over 80, for the rest of this Parliament; and
- free television licences for the over 75s, and free eye tests and prescriptions for those aged 60 and over.

[11] *Pensions: Challenges and Choices, The First Report of the Pensions Commission*, Pensions Commission, October 2004.

Payment to over 70s

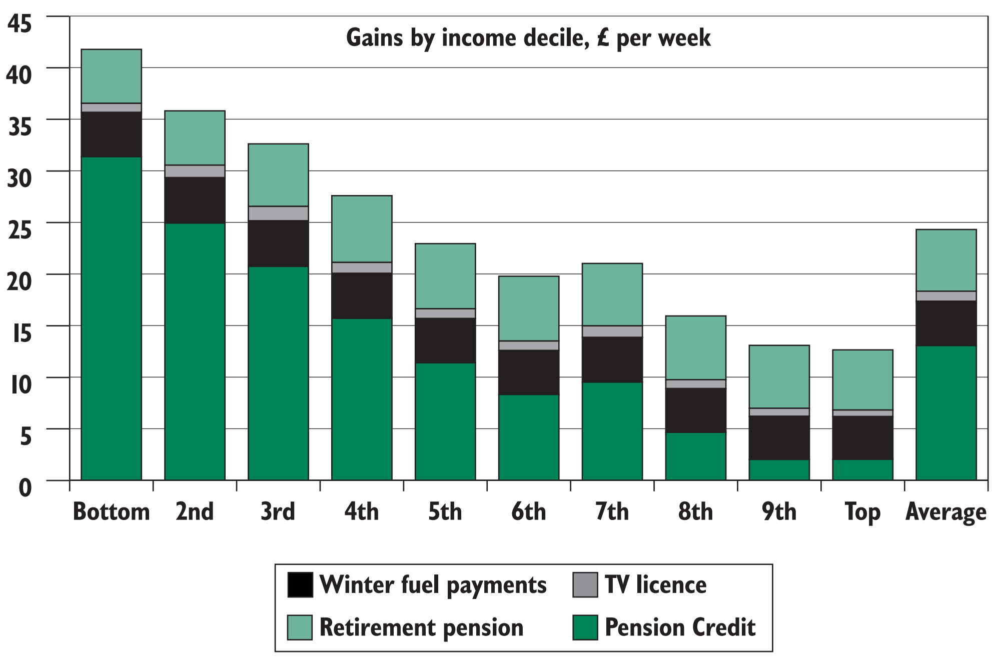
5.58 The Government understands the position of older people on fixed incomes facing pressures such as council tax bills. Alongside Council Tax Benefit, the Government believes that it is right to help older pensioner households with their council tax and other living expenses. **This Pre-Budget Report therefore announces that, in addition to these existing measures, the Government will make a payment of £50 to households with someone over age 70 in 2005**.

Effects of measures to support pensioners

5.59 Chart 5.2 shows the distributional impact of the Government's measures to support pensioners. Relative to the 1997 system, the Government will spend £10 billion more on pensioners in 2005-06 as a result of tax and benefit measures it has introduced, with the result that:

- the poorest ten per cent of pensioner households will be on average £2,170 a year, or around £42 a week, better off; and
- pensioner households will be, on average, £1,350 a year better off, or around £26 extra a week.

Chart 5.2: Overall gains for pensioner families from pensions policies by 2005



5.60 As a result of measures implemented since 1997, the Government is spending £10 billion a year more on pensioners – £7 billion a year more than if it had simply linked the basic state pension to earnings over the same period. The Government's strategy is not only more generous overall, but has also focussed support on those who need it most. If the extra £10 billion had been spent on raising the basic state pension then the poorest ten per cent of pensioners would on average be £23 a week worse off than they are now.

Support for pensioners who pay tax

5.61 Almost half of pensioners pay no income tax. For those who do, the age-related personal allowances in 2005-06 will rise in line with earnings to £7,090 for people aged between 65 and 74 and to £7,220 for those aged 75 and over. The age-related personal allowances will continue to rise at least in line with earnings rather than prices for the remainder of this Parliament. This means that no person aged 65 or over need pay tax on an income of less than £136 a week.

Box 5.2: Pension Credit

To tackle pensioner poverty while rewarding saving for retirement, the Government has built on the Minimum Income Guarantee with the launch in October 2003 of the Pension Credit. The Pension Credit already benefits 2.6 million pensioner households, and the Pension Service has a target of 3 million pensioner households by 2006 rising to 3.2 million by 2008, and is working with local authorities and the voluntary sector to achieve this.

Pension Credit currently provides a guaranteed minimum income of £105.45 a week for single pensioners, which will rise to £109.45 from April 2005. This means pensioners no longer have to live on as little as £69 a week as they did in 1997. Pension Credit also rewards 1.9 million pensioners who have saved for their own retirement, and has ended the unfair penalty on many savers of a 100 per cent marginal deduction rate on their savings.

Women pensioners, who in the past have not been able to build up an entitlement to a full basic state pension, have been among those to benefit the most from Pension Credit. Although only 48 per cent of women currently receive a full basic state pension, twice as many women receive Pension Credit as men.

Claiming Pension Credit is a much simpler process than previous application processes. The application form is relatively short and straightforward and can be completed largely over the telephone with the help of an advisor, who then sends it to the claimant to sign and return. From age 65, provided their circumstances do not change, most applicants have their entitlement fixed for five years.

Fairness for tomorrow's pensioners

5.62 The Government is committed to providing a clear and sustainable framework for retirement provision within which individuals can make effective choices about how much to save and when to retire, as set out in the Pensions Green Paper in 2002. Since then, the measures in the Green Paper have been developed and taken forward through legislation and the publication of *Informed choices for working and saving.*[12] The Government's policies aim to deliver:

- *a guarantee of a decent minimum income in retirement* – provided by the state, and below which no pensioner need live;
- *transparency* – the Government's Informed Choice programme is helping people to make informed and effective choices about working and saving for their retirement;
- *simplicity* – the Government is simplifying the tax regime for pensions, and ensuring that people have access to simple and flexible savings products;
- *security* – the Pension Protection Fund and a new pro-active regulator will improve protection for members of occupational pension schemes; and
- *opportunities for extended working lives* – the Government is combating age discrimination and enhancing the rewards for those choosing to defer taking their state pension, providing people with greater opportunity and rewards for working longer if they wish to do so.

[12] *Simplicity, security and choice: Informed choices for working and saving*, Department for Work and Pensions, February 2004.

5.63 The Government establised the Pensions Commission in 2002 to keep under review the regime for UK private pensions and long-term savings, and assess how effectively the current voluntarist approach is developing over time. On the basis of this assessment, the Commission will make recommendations to the Secretary of State for Work and Pensions on whether there is a case for moving beyond the current voluntarist approach. The Pensions Commission published its interim report *Pensions: Challenge and Choices* in October 2004. The Government welcomes this report, which furthers understanding of the challenges posed by an ageing population, and looks forward to the Commission's second report on policy recommendations in Autumn 2005. The interim report makes several recommendations on data adequacy, which the Government accepts. The Government will respond to the long-term savings issues raised by the Commission. The nature of any response will be guided by the imperative of maintaining long-term fiscal sustainability.

A decent mimimum income for all

5.64 The Government is committed to guaranteeing a decent minimum income in retirement. From April 2005, the guarantee element of the Pension Credit will stand at £109.45 for single people and £167.05 for couples. The Basic State Pension will rise to £82.05 for single pensioners from April 2005, representing a rise of 7 per cent in real terms since 1997. In addition, the Government reformed the State Earnings Related Pension Scheme (SERPS) by introducing the State Second Pension in April 2002. This increased the rights built up by those on low and moderate earnings, as well as by disabled people and carers. Someone earning half median earnings, around £11,000 per annum, will be able to accrue a weekly State Second Pension of around £70 at retirement in 2050, in today's earnings terms; roughly double what would have been built up under SERPS.

Informed choice

5.65 Beyond the foundation provided by the Government, it is for individuals and families to decide for themselves what income they wish to receive in retirement. The Government is working with employers and the pensions industry to provide timely, accurate and tailored information that will enable people to make informed choices about their retirement provision. Measures include:

- issuing nearly 3 million forecasts in 2003-04. 1.3 million of these were combined forecasts, which contained information relating to both state pension accruals and current private pension saving. The Pensions Act 2004 provides the Government with a reserve power to require that pension schemes provide these combined forecasts, should evidence show that they make a significant difference to savings levels. The 2004 Spending Review set DWP a PSA target to ensure that by 2007-08 over 15 million individuals are regularly issued with a pension forecast;

- a web-based retirement planner, which DWP will deliver by the spring of 2006. This will enable people to consider the impact on their retirement income of varying savings behaviour or working longer than currently planned; and

- piloting the use of information and advice in the workplace. The Pensions Act 2004 provides reserve powers to require employers to ensure that their employees have access to a decent standard of pension information.

5.66 *Informed Choices for working and saving* also sets out ways by which individuals could maximise the opportunities to save available to them in the workplace. The Government is exploring automatic enrolment in employers' pension schemes. The Pensions Commission confirmed that such approaches could increase take up significantly.

Pension tax incentives

5.67 Individuals need clarity around the tax treatment of their pension saving. The existing eight taxation regimes create complexity, each with its own set of rules. Following an announcement in Budget 2004, Finance Act 2004 legislated for a single universal regime for tax-privileged pension savings, which will come into effect in April 2006. As well as providing individuals with greater flexibility and choice over their retirement savings, tax simplification will benefit employers and pension providers through a reduction in administrative costs. The Government is responding to representations made on the Finance Act 2004 legislation, and will introduce a package of supplementary measures in Finance Bill 2005. There will also be further modifications, including a new transitional rule to allow certain funeral expenses currently paid by occupational schemes to continue to be paid tax free.

5.68 The Government has implemented reforms to ensure that savings pays. Pension Credit provides the Savings Credit reward to 1.9 million pensioners who have saved for their own retirement, and has ended the unfair penalty on many savers of a 100 per cent marginal deduction rate on their savings. The Financial Services Authority has concluded that, as a result of the Savings Credit, "*for most people, most of the time, it will pay to have saved*".[13]

Stakeholder pensions

5.69 In addition to information and transparency, individuals need access to simple, good value products. The introduction of 'Stakeholder' pensions has ensured that value-for-money, flexible private pension arrangements are available to all. The review of the charge cap in June 2004 should further extend the reach of these products. Stakeholder pensions are one element of the Stakeholder suite described earlier in this chapter.

Pension protection

5.70 The Government has a role in ensuring that there is appropriate regulation of the pensions and savings industry. To rebuild confidence in saving, the Government acted to ensure that victims of personal pensions mis-selling were compensated where this was appropriate. The Government has introduced legislation through the Pensions Act 2004 to establish the Pension Protection Fund (PPF). This is the UK's first scheme for ensuring that individuals in defined benefit pension schemes receive a meaningful proportion of their expected pension income if their sponsoring employer becomes insolvent. At the same time, the Government has introduced legislation to strengthen and refocus the Pensions Regulator, enabling it to take a risk-based approach and use its resources more effectively. In addition, the Government is providing a package of assistance for those people who have lost out due to their pension scheme being wound up, when the sponsoring employer became insolvent, prior to the introduction of the PPF.

Enabling longer working lives

5.71 The Pensions Commission's analysis confirmed that working longer will be an important part of the response to increased life expectancy. Of those aged between 50 and state pension age, the employment rate has risen from 65 per cent in 1997 to 70 per cent now. Furthermore, there are now nearly 1 million people over state pension age in employment. Chapter 4 sets out the Government's employment strategy, which contains measures to further improve the employment opportunities of older workers. The Government does not believe it is right to force people to work longer and has no plans for a crude increase in the state pension age, but it is providing greater choice and flexibility for those who wish to do so, including:

- measures which mean that it will be possible to draw an occupational pension while remaining with the same employer;
- ensuring that from April 2005, those who choose to defer taking their state pension will be rewarded, either with weekly payments that increase by 10.4 per cent for each year of deferral or, alternatively, by a taxable lump sum. Tax will be applied to the lump sum at the marginal rate and it will not affect any

[13] *FSA Factsheet: Stakeholder Pension and Decision Trees*, Financial Services Authority, April 2004.

age related allowance due. Claimants will be able to self declare their appropriate tax rate and the tax will be deducted before the payment is made; and

- legislation, which the Government will bring into force in 2006, to implement the age discrimination strand of the European Employment Directive.

SUPPORTING COMMUNITIES, CHARITIES AND GIVING

5.72 The voluntary and community sector (VCS) plays a central role in creating a fair and enterprising society with a culture of volunteering and giving. The Government has provided a wide range of tax reliefs and special provisions to support the VCS, which are now worth more than £2.4 billion a year, and provides additional support through a number of programmes and initiatives. The Government sees enhanced consultation and engagement with the VCS as key outcomes from implementation of the O'Donnell Review recommendations for the integration of Inland Revenue and HM Customs and Excise and the strengthened capacity for tax policy development at HM Treasury. The Government is committed to further action to support the work of the VCS in:

- developing stronger local communities;
- taking a greater role in public service delivery, described in Chapter 6;
- engaging people in volunteering and mentoring; and
- engaging the corporate sector in meeting community needs.

Volunteering and giving

5.73 The Government will launch the 2005 Year of the Volunteer at a 'Local Heroes Ceremony' in January. Through the Year of the Volunteer, the Government will work with the VCS and corporate sector to promote the universal benefits of volunteering. All private and public sector employers, including Government departments, should consider their contribution to creating a culture of volunteering, spreading best practice, and raising overall levels of voluntary activity. In May 2004, the Home Secretary and Chancellor launched a Commission, led by Ian Russell, Chief Executive of Scottish Power, to examine how to achieve a step change in youth volunteering and engagement, building on the valuable contribution young volunteers already make in our communities. The Commission published its consultation document in October 2004, seeking views on how to engage more young people in volunteering, enhance the range and quality of volunteering opportunities and give the achievements of young volunteers greater recognition. The consultation period closes on 31 December 2004 and the Commission will report in spring 2005 on a new national framework.

5.74 The Government strongly supports the impact volunteer mentors can have on improving the life chances of others, particularly young people. A new National Mentoring and Befriending Body, supported by the Home Office and to be launched during 2005, will raise the profile of mentoring and ensure that quality standards are maintained and strategic links to Volunteer Centres are developed. It will be supported by regional mentoring and befriending bodies and a series of local mentoring projects with a track record in delivery. Building on this, the Government will work with schools, the business sector and the VCS to explore the potential for greater corporate involvement in mentoring through the Corporate Challenge.

5.75 The Chancellor and Home Secretary will host a Volunteering Conference in January 2005 with representatives from the VCS and business. The Conference will discuss the Russell Commission, mentoring, and finance issues such as existing funding and the use of existing tax incentives.

Corporate Community Involvement

5.76 High quality, mutually beneficial links between local businesses and their communities provide effective frameworks for the giving of both time and money. In the 2004 Spending Review, the Government announced it would look to business to take forward a national campaign during 2005, as part of the business-led Corporate Challenge, to promote Corporate Community Involvement via an increase in employer support for Payroll Giving, employee volunteering and corporate charitable activity. The Campaign will provide an opportunity to highlight how corporate community involvement can contribute to reducing poverty, promoting an inclusive society and raising economic productivity.

5.77 The Government is committed to ensuring that the generous set of tax incentives available to encourage corporate giving is understood and used. The *Guide to Tax Incentives for Corporate Giving*, to be published shortly, will explain this set of incentives; helping to boost corporate tax efficient giving in the 2005 Corporate Challenge National Campaign.

Payroll Giving

5.78 In 2004, around 530,000 employees gave £85 million to charity through Payroll Giving, with one in five employees having access to a Payroll Giving scheme. The Government believes that employees should benefit from the opportunity to make regular charitable donations provided by Payroll Giving. Following the announcement in Budget 2004, the Home Office has launched an £8.3 million scheme to improve access to Payroll Giving and encourage more of the UK's 12 million employees in small- and medium-sized enterprises (SMEs) to give to charity. The scheme works in two parts: SMEs will receive a grant of up to £500, depending on their size, when they establish a scheme; and the Government will match each employee's donation pound-for-pound, up to a maximum of £10 per month for six months, from when the employee signs up.

Gift Aid

5.79 Changes to Gift Aid announced in Budget 2000 have achieved a considerable increase in the number of charities and donors using Gift Aid. In 2003-04, nearly 56,000 charities claimed tax repayments of £586 million on Gift Aid donations, compared with 25,000 charities claiming tax of £222 million on donations in 2000-01.

5.80 In the 2003 Pre-Budget Report, the Government announced changes to the Gift Aid scheme so that certain heritage and conservation charities could not turn admission charges into donations on which Gift Aid could be claimed. These admission schemes do not encourage greater giving to charity, which is the essential purpose of the Gift Aid scheme. It is also unfair that only certain charities have been able to use Gift Aid in this way. After detailed discussions with the charity sector, an approach has been established which upholds the principles of Gift Aid, while recognising the unique position of charities dependant upon visitor support. To encourage additional Gift Aid donations and support for charities, **the scope of the statutory exemption, which allows for the right of free admission to be disregarded as a benefit, will be expanded to allow more types of charities reliant on visitor support to benefit**. The Government will discuss with the charity sector how the broader scope of the exemption will be defined. In addition, the exemption will be amended so **Gift Aid will apply where the donation is at least 10 per cent more than the normal admission charge, or where the donation results in the unlimited right of admission for a period of not less than 12 months**. The Government will introduce these changes in April 2006 to allow time for charities to make the necessary preparations to operate the new scheme.

Unclaimed assets

5.81 As set out in Budget 2004, the Government believes that it is right in principle that more should be done to reunite assets with their owners and it welcomes the continued efforts of the British Bankers' Association, the Building Societies' Association and National Savings and Investments in trying to do so. Where assets and owners cannot be reunited, the assets should be reinvested in society, as long as the original owners' entitlements to reclaim are preserved. The Government asked the industry to expand the scope of action beyond investment banking into retail banking and the wider financial sector. Following the Budget, the Government has held constructive discussions with the industry to take this forward and will report on progress in due course.

Football Supporters' Trusts

5.82 The Government is keen to support Football Supporters' Trusts in the important work they do for the community. Following a review launched in the 2003 Pre-Budget Report, **Inland Revenue will now work with Supporters Direct to provide guidance and dedicated support for Football Supporters' Trusts to set up charities or Community Amateur Sports Clubs to run their community activities, and to help them take advantage of the range of tax reliefs available to such bodies.**

DELIVERING A MODERN AND FAIR TAX SYSTEM

5.83 A modern and fair tax system encourages work and saving, keeps pace with developments in business practices and the global economy and provides the foundation for the Government's objective of building world-class public services.

Protecting tax revenues

Tackling non-compliance

5.84 For such a system to be effective, everyone needs to pay their fair share of taxes and receive the tax credits they are entitled to. Tax avoidance and tax or tax credit fraud undermine the ability of the tax system to deliver its objectives, imposing significant costs on society. The Government has always made clear its determination to tackle such non-compliance, to ensure the tax system is fair and is seen to be fair.

5.85 Since 1997, the Government has taken a series of steps to crack down on those who abuse the system. These have included structural reforms that make the system less vulnerable, closing loopholes in the law and improving the way HM Customs and Excise and Inland Revenue deliver their compliance functions. However, economic and social change, including globalisation, is providing new opportunities for those determined to avoid or evade their obligations. Continual vigilance and action are therefore needed.

A modern organisation

5.86 The integration of HM Customs and Excise and the Inland Revenue, described further in Chapter 3, and the strengthened capacity for tax policy development at HM Treasury, represent a natural next step in developing a strategic approach to improving compliance. A modern organisation, using modern compliance tools, will be well placed to rise to the continuing challenge from non-compliance. This approach will be based on two key principles of fairness and customer focus, ensuring activities are effectively tailored to the needs and behaviours of different customers.

5.87 A key part of this approach will be to encourage customers to comply voluntarily as the best way of improving compliance. Reducing the costs faced by compliant taxpayers will be a priority. However, the Government is also determined to take vigorous action against those who choose not to comply. The compliant majority should not pay the price for others who deliberately flout their obligations to pay a fair share. Intensifying efforts to combat avoidance and fraud will therefore also be a central feature of the approach.

Tackling avoidance schemes

5.88 Tax avoidance schemes are often sophisticated and aggressive in nature and thrive in an environment of secrecy. Such schemes represent an unacceptable attack on the integrity of the tax system. In Budget 2004, the Government introduced disclosure rules to tackle tax avoidance schemes for both direct taxes and VAT. These rules are already achieving their purpose of allowing earlier and more targeted action against avoidance schemes. The Government welcomes the generally positive reaction of the business community to the disclosure rules and intends to continue to use disclosures received to counter avoidance and to ensure improved design of tax policy in the future.

Avoidance of tax on remuneration

5.89 **The Government is taking action in this Pre-Budget Report to remove the ability to avoid Pay As You Earn (PAYE) and national insurance contributions (NICs) liability on certain remuneration arrangements**. This follows action by the Government in recent years against a variety of schemes, particularly ones designed to avoid tax and NICs on bonuses received by higher paid employees. To prevent exploitation of similar loopholes, **the Government has also announced in a statement issued alongside the Pre-Budget Report that it is prepared to bring forward legislation to counter any schemes of this type which are developed in the future. If necessary, such legislation would be effective from today**.

Other direct tax avoidance measures

5.90 In addition, the Government is taking action to close a number of loopholes currently being exploited to avoid tax, including:

- **stopping the uncommercial use of options to avoid tax on capital gains or to generate capital losses;**
- **closing down the use of stripped corporate bonds to avoid income tax; and**
- **a number of measures to counter avoidance in the corporate and financial sectors including abuse of the Controlled Foreign Companies rules, schemes involving annual payments and relief for foreign taxes, artificial arrangements to avoid tax on profits from debt securities, and abuse of the life company taxation rules.**

Film tax

5.91 **The Government is closing a number of avoidance schemes that exploit the tax reliefs for UK film production.** The Government remains committed to promoting a sustainable British film industry, and confirmed this commitment by launching, on 21 September, details of a new tax credit for British qualifying films with production budgets up to £20 million. The new tax credit has been welcomed by the industry, and the Government is engaged in discussions with industry representatives to increase its understanding of the industry and to develop the detail of the operation of the credit. In light of the steps taken against film tax avoidance both today and in recent years, and of the development of the new tax credit for low budget British films, the Government will consult with the UK Film Council and the industry in an early review of the tax relief that is used by large budget British films, that will conclude at the end of January 2005.

Tackling VAT losses

5.92 In April 2003, the Government launched a VAT compliance strategy to tackle revenue shortfalls across the VAT system and to improve the service that Customs offers to VAT registered businesses. In 2003-04, the first year of the strategy, the shortfall of revenue fell sharply to 12.9 per cent of theoretical liabilities from 15.8 per cent in the previous year. Further details are available in *Measuring and Tackling Indirect Tax Losses – 2004* published today by HM Customs and Excise. Further measures to tackle VAT losses announced today include:

- **blocking an off-shore scheme that seeks to avoid VAT incurred on settling UK insurance claims; and**
- **ensuring fair VAT recovery on share issues.**

Tackling tobacco smuggling

5.93 Tobacco smuggling undermines the Government's health objectives, involves serious and widespread criminality, and costs over £2.5 billion a year in lost tax revenue. Since the introduction of the tobacco strategy in 2000,[14] the illicit cigarette market share has fallen to 15 per cent, down by more than a quarter from its peak.

[14] *Tackling tobacco smuggling*, HM Customs and Excise, March 2000.

5.94 The Government is concerned about the continuing significant smuggled share of the hand-rolling tobacco market, and is looking to see how the lessons learnt from the success of the strategy for tackling tobacco smuggling, can be applied to tackle smuggling of hand-rolling tobacco. As a first step, Customs will be working with tobacco manufacturers to reduce the supply of hand-rolled tobacco to smugglers, and making an impact on passenger smuggling gangs.

Combating alcohol fraud

5.95 The Government is committed to taking action to tackle alcohol fraud that is both tough and proportionate. Since Budget 2004, the Government has worked closely with the spirits industry to develop the details of the duty stamps system to be introduced in 2006 to combat spirits fraud.

5.96 Updated estimates published today provide encouraging signs that Customs have made progress in tackling spirits fraud. This progress does not remove the need or case for further measures, but emphasises the importance of implementing those measures in a way that keeps the compliance costs for the legitimate trade to a minimum. Therefore, in addition to freezing spirits duty for the remainder of the Parliament and meeting the additional printing and distribution costs entailed by duty stamps, the Government:

- **has decided, based on industry proposals, to make targeted exemptions from the duty stamps regime;**
- **has decided to adopt the industry's proposal to allow duty stamps to be incorporated into bottle labels, and, subject to further work with the industry on detailed stamp design, is inclined to allow additional flexibility in the format of stamps; and**
- **believes there is a case for not attaching a financial liability to duty stamps, and will work further with the industry to examine the implications of this for the impact of duty stamps on both fraud and compliance costs before making a final decision.**

5.97 As a result of incorporating these features into the planned duty stamps system, overall compliance costs – at the time of the Budget estimated by the industry at £23 million start-up and £54 million a year ongoing – could be reduced to £7 million start-up and £5 million a year ongoing based on the industry's estimates. This means duty stamps remain a proportionate measure, including in the context of updated estimates of the level of spirits fraud. Further details are set out in a business brief published by Customs today.

Oils fraud

5.98 The UK oils strategy has reduced the illicit diesel market share in Great Britain from 8 per cent in 2000 to 6 per cent in 2003. This comprehensive strategy is focused on stopping large-scale commercial and criminal fraud through a combination of law enforcement activity and better controls of the sale and distribution of the oils involved. HM Customs and Excise has already put in place a new assurance regime that has made the supply chain for red diesel and kerosene more transparent, making it easier to identify and take action against fraudsters. To tackle the risk that they may shift to misusing other oils, especially aviation turbine fuel and marine gas oil, Customs will explore with the trade options for increased fraud proofing of these products. Budget 2004 announced the narrowing of the differential between main road fuels and rebated oils by one penny per litre, though this was defered in July as part of the wider fuel duty decision. The Government today confirms that it will implement the narrowing of this duty differential, as discussed in Chapter 7, in support of the UK oils strategy and with the aim of further reducing the illicit market share.

Protecting the UK tax base

5.99 The Government is determined to defend the corporation tax system robustly against legal challenges under EU law. Discussions with business on the wider issues raised by legal developments are continuing. The Government will also continue to monitor the impact of international accounting standards on the corporation tax base.

Modernising the tax system

Income tax and NICs

5.100 The income tax personal allowances for those aged under 65 will increase in line with inflation in 2005-06. The NICs threshold and limits will also increase in line with inflation. There will be no change in NICs rates for employers and employees, or the profit-related NICs paid by the self employed. Annex B provides further details of the changes to the rates and allowances within the tax and benefit system announced in this Pre-Budget Report.

Residence and domicile

5.101 The Government is continuing to review the residence and domicile rules as they affect the taxation of individuals, and is considering various aspects of this issue in respect of the responses to the background paper published at Budget 2003.[15] The Government remains determined to proceed on the basis of evidence and in keeping with its principles. It would welcome further contributions to the debate, which will then be taken forward by the publication of a consultation paper setting out possible approaches to reform.

Small businesses

5.102 The Government remains committed to providing targeted support to small businesses, including appropriate tax incentives to support its growth and productivity objectives. However, in some areas, the pursuit of these objectives through the tax system may be constrained by the ability to match definitions for tax purposes with the underlying characteristics of firms. **The Government is today publishing *Small companies, the self-employed and the tax system: a discussion paper*, and welcomes the views of smaller firms and their advisers on the strategic issues raised**.

Leasing

5.103 As part of the Government's continuing commitment to modernise the corporation tax system, it has considered the tax treatment of leased plant and machinery. **Following a period of constructive consultation, the Government has decided to align the tax treatment of leasing with that of other forms of finance**. Detailed proposals are contained in the Technical Note on Corporation Tax Reform,[16] published today, and consultation will continue on the details of the new regime. The Government intends to legislate for this in Finance Bill 2006. Leasing is an important source of finance for small businesses, who typically use shorter leases. The Government has therefore brought forward proposals to ensure that such leases remain outside the new regime.

Pooled investment schemes

5.104 In the light of the new FSA regulations and the introduction of Qualified Investor Schemes, the Inland Revenue issued a technical paper in July 2004 discussing possible changes to the tax regime for Authorised Investment Funds (AIFs). A summary of responses is available on the Inland Revenue website. Following this, **the Government intends to bring forward a modernising package including a number of technical changes**, for example clarifying the taxation for unit trusts that have multiple classes of units and introducing a measure that applies the taxation arrangements for AIFs only to those funds where each investor holds less than 10 per cent of the fund. The Government also continues to examine the scope for simplifying and modernising the taxation of pooled investment schemes and it welcomes and invites a more strategic approach from the industry on whether radical reform similar to that under way for pensions is viable.

[15] *Reviewing the residence and domicile rules as they affect the taxation of individuals*, HM Treasury and Inland Revenue, April 2003.

[16] *Corporation tax reform: technical note*, Inland Revenue, December 2004.

Accrued Income Scheme

5.105 Following the positive responses to the consultation published at Budget 2004,[17] the **Government has decided to proceed with simplification of the Accrued Income Scheme**. There will be further consultation on the detail with a view to legislation.

Shari'a compliant financial products

5.106 The Government recognises that individuals and businesses wish to have access to financial products that comply with Shari'a Law. The Government welcomes the progress that has been made in developing suitable products and the contribution that these developments will make to the financial sector, and to the opportunities available for both business and personal customers. **The Government is consulting on how to encourage further innovation and ensure that tax does not create an impediment to the development of new products in this area, and is considering legislative options for the 2005 Finance Bill**.

Travellers' allowances

5.107 The Government supports cross-border shopping and is against excessive restrictions being applied to travellers who bring goods into the country for their own use. Travellers may currently bring goods (excluding alcohol, tobacco and perfume) up to a total value of £145 from outside the EU into the UK, without being required to pay tax or duty on arrival. This limit applies to all EU Member States and would require unanimous agreement in order to be changed. The last review of the EU travellers' allowance took place in 1994. **The Government believes that the £145 limit is now out of date, and has proposed to the European Commission that it be raised, in order to better support cross-border shoppers**.

TACKLING GLOBAL POVERTY

5.108 The UK is committed to eliminating poverty in the long-term and achieving the internationally agreed Millennium Development Goals (MDGs), which include halving poverty, combating HIV/AIDS, malaria and other diseases and achieving universal primary education by 2015. As set out in Box 5.3, the Government will use the UK's Presidencies of the G7/8 and EU in 2005 to press for further international action.

5.109 The United Nations (UN) has warned that, although progress is being made globally on reducing poverty, most developing countries are not expected to meet more than three of the seven MDGs by the target year of 2015.[18] 2005 is the target year for the first MDG of eliminating gender disparity in primary and secondary education, and this aim will be missed.

The challenge of 2015

5.110 One of the major reasons for the lack of progress is the need for large-scale and sustained investment in health, education, sanitation and economic development, which underpin all these goals. The UK is leading the way in pushing for increased resources for development to overcome this gap in funding. In addition to higher UK aid flows, the Government has proposed the International Finance Facility (IFF), described further in Box 5.4. Alongside action to increase funding, the UK is pushing for further and deeper debt relief, and supporting established mechanisms for reducing poverty such as improving trade conditions. To meet the MDGs it is crucial that *aid, trade and debt relief* are all tackled together. For example, aid is needed to help poor countries build up the investment in the infrastructure and capacity that they need to respond to new trading opportunities.

[17] *Options for the reform of the Accrued Income Scheme*, HM Treasury and Inland Revenue, March 2004.

[18] *Human Development Report 2003*, United Nations Development Programme, 2003.

The Commission for Africa

5.111 The Government attaches particular importance to the eradication of poverty in Africa. The Commission for Africa (CfA) was established in February 2004 by the Prime Minister to determine which policies have been effective and where more can be done to support Africa's development, in particular by the international community. There are seventeen Commissioners – nine from Africa – representing government, business, development institutions and civil society. It is for Africa to shape its own future, and the Commission will work in support of African processes and institutions, particularly The New Partnership for Africa's Development (NEPAD) and the African Union, to achieve the most comprehensive assessment possible. The findings of the Commission will feed into the UK's Presidencies of the G7/8 and EU.

Box 5.3: Mobilising international support for development in 2005

In 2005, the UK will put development at the top of the international agenda through the Presidencies of the G7/8 and the EU. No countries, or regions of the world, should be left behind in the general increase in global growth and prosperity. On current rates of progress, Africa will not reach any of the internationally agreed Millennium Development Goals (MDGs) by the target date of 2015. There are three main areas in which the Government will be using the Presidency to push for action, all three of which are needed to meet the MDG targets:

Aid: **donor governments must continue to progress towards the target of spending 0.7 per cent of GNI on aid. To have the maximum impact on achieving the MDGs, the UK will press for this aid to be front-loaded through the International Finance Facility (IFF), described in Box 5.5. The IFF would release significant resources in areas such as education, health and trade infrastructure between now and 2015.**

Debt relief: **the UK will use its Presidency to continue to spearhead international action to relieve the debt burden of the world's poorest countries. In 2005, the UK is seeking G7/8 and EU commitment to finance 100 per cent of the debt service owed by poor countries to multilateral institutions. The international community should also agree 100 per cent relief on debts owed by poor countries to the IMF. This relief should be financed through better use of IMF gold reserves.**

Trade: **the UK is seeking an ambitious outcome to the Doha Development Agenda in the WTO, and a reform of the EU's Common Agricultural Policy that will benefit poor countries, and will be pushing for action to better enable developing countries to benefit from access to rich country markets. Developing countries must be able to carefully design and sequence trade reforms within their own development and poverty reduction strategies, with support through additional finance. The Government will press for investment in the infrastructure and capacity poor countries need in order to respond to new trading opportunities, and will consider how to provide transitional assistance to help countries adapt and reap the benefits of more open global markets while ensuring the most vulnerable people are protected.**

5.112 In parallel to the work of the Commission, the UK will continue to support African-led peacekeeping operations, especially in their efforts to end the current humanitarian crisis in Darfur. The UK is determined to provide the fullest possible assistance to achieve a lasting peace in Sudan, and is the second largest bilateral contributor. The Government has allocated £62.5 million for humanitarian assistance in response to the Darfur crisis between September 2004 and March 2005. The 2004 Spending Review set aside a further £150 million for humanitarian and emergency relief in Sudan over the next three years, to be called on at any time.

5.113 The UK recognises the importance of an African-owned peace and security agenda, and that African peacekeeping provides a cost-effective alternative to UN interventions. Enhancing the capacity of African-led peacekeeping will be a priority for the UK G7/8 and EU Presidencies, including continuing support for the G8's Africa Action Plan and working with NePAD. Building the capacity of the African Union, as a major regional body for managing African Peace Support Operations, will be a key strategy for delivering this enhancement to African peacekeeping in 2005 and beyond.

Overseas aid

5.114 The UK is fully committed to achieving the UN target for overseas aid of 0.7 per cent of Gross National Investment (GNI). The 2004 Spending Review announced that by 2007-08, total UK aid will rise to nearly £6.5 billion a year, representing 0.47 per cent of GNI, a real terms increase of 140 per cent since 1997. This substantial increase will allow the UK to continue to be a world leader on development, and demonstrates the UK's commitment to helping the world's poor and working towards the MDGs. The Government aims to sustain the rate of aid growth it achieves in 2007-08, which would mean that total UK overseas development assistance would reach 0.7 per cent of GNI by 2013. If the proposal for the IFF is agreed, the equivalent of 0.7 per cent of GNI could be achieved in 2008-09.

5.115 Reflecting the importance of Africa to achieving the MDGs, UK bilateral aid to Africa will rise from £1 billion per year to at least £1.25 billion per year by 2007-08. Over the next three years, the UK will spend at least £1.5 billion on HIV/AIDS related programmes to counter the growing threat of the pandemic. To mark the 20th Anniversary of the Live Aid concert in 2005, the Chancellor has announced that the Government will make a special donation to the Band Aid Charitable Trust to cover the cost of VAT collected on the new Band Aid single and Live Aid DVD. The Government will do all it can to support the work of Band Aid and ensure that all proceeds from sales of the new single and DVD go to support the vital work of the Band Aid Trust in the poorest countries of Africa.

Debt relief

5.116 The Government has been a champion of the cancellation of debt through the Heavily Indebted Poor Countries (HIPC) Initiative. The Initiative is providing over $70 billion of debt service relief, allowing savings to be used for country-owned poverty reduction strategies which encourage pro-poor growth and work towards the MDGs. An extension of the Initiative for two years was agreed in October 2004 which will enable a further ten countries to receive debt relief, making possible a further debt write-off of more than $30 billion.

5.117 Recognising that the HIPC initiative cannot guarantee debt sustainability in all cases and that countries are still facing significant debt burdens, the UK proposes that donors should go further and match up to 100 per cent bilateral debt relief with up to 100 per cent multilateral debt relief. This should be achieved through the provision of extra funding and the revaluation or sale of IMF gold to guarantee increased resources for poverty reduction. The Government will continue to call on other donors to join the UK in paying for their share of multilateral debt relief, and will urge the IMF to consider anew all options for financing its share of 100 per cent debt relief.

5.118 In the absence of international agreement to provide 100 per cent multilateral relief, the UK will pay its share of the debt service owed to the World Bank and African Development Bank's concessional financing arms on behalf of eligible countries from January 2005. The UK has widened the criteria to include both post Completion Point HIPCs and low-income countries with suitably robust public expenditure management systems, and the 2004 Spending Review set aside funding for this purpose. This debt service relief will be guaranteed up to 2015 for all eligible countries to ensure resource support for achieving the MDGs. It is estimated that relieving the IMF debts of unsustainable HIPCs would cost the IMF around $7 billion. G7 Finance Ministers have been asked to report by the end of the year on ways to strengthen debt sustainability in the world's poorest countries.

Box 5.4: The International Finance Facility (IFF)

Fiscal constraints mean that many international donors will not reach the UN aid target of 0.7 per cent of Gross National Income in the short term. An estimated extra $50 billion is needed annually to meet the MDGs. The IFF is designed to deliver the necessary funding to achieve the MDGs ahead of 2015 by frontloading aid to allow developing countries to invest in sustainable long-term poverty reduction strategies. The IFF is not a replacement for progress towards the 0.7 per cent target, on which the UK remains focused. Funding for debt relief should reinforce, not replace, funding to build a skilled work force and the infrastructure and capacity to trade. As a stable financing vehicle, the IFF would provide the critical mass of additional and predictable funding needed to make lasting progress in all these areas. Alongside sustainable debt relief and achieving agreement on global trade, the IFF has the capacity to provide a lasting solution to the needs of the developing world through raising the resources needed to tackle the causes as well as the symptoms of poverty. Given the urgency to act now, the UK is taking immediate steps towards finalising the technical details of the proposal ahead of the launch, and the IFF will play a key part of the UK's Presidencies of the G7/8 and EU in 2005.

The World Bank and IMF have stated that the IFF is the most advanced proposal to frontload aid, and that it is technically feasible. France is a strong supporter of the IFF, and Italy has recently announced that it will support the IFF and work jointly with the UK and other international partners towards its implementation. Working groups from various countries have agreed that the IFF will provide stable and predictive development financing.

The UK – together with France and the Global Alliance for Vaccination and Immunisation – is finalising the details for an IFF for immunisation (IFFIm) that will demonstrate the principles of frontloading. This proposal could save up to 5 million lives ahead of 2015 and make a significant contribution to the MDGs. It is expected that the IFFIm will be launched in the first half of 2005.

Trade

5.119 The Government believes that trade and investment are key to reducing poverty in developing countries by promoting long-term economic growth, as set out in *Trade and the global economy*, published by the Treasury in May 2004. Subsidies and trade barriers prevent poor countries from selling their goods. Every year agricultural protectionism in developed countries costs the world's poorest countries over £50 billion. The Government is committed to reducing these barriers, in particular by reforming the Common Agricultural Policy and by delivering a Doha Development Agenda in the World Trade Organisation that is favourable to developing countries. It is important that developing countries are able to carefully design and sequence trade reforms within their own development and poverty reduction strategies. For example, they must be equipped with the infrastructure and capacity to realise the potential benefits of open trade. To achieve this, richer countries should be ready to support – with additional finance – investment in health, education, infrastructure and protecting the most vulnerable citizens. Investment in social programmes using the front-loaded resources provided by the IFF will ensure that developing countries have the essential building blocks for production and trade.

Health

5.120 It is vital to invest in the health of people in the developing world to reduce mortality rates and increase life expectancy; and also to increase productivity and drive economic growth. Underlying this is the need to support the development of health systems that are responsive to the needs of poor people, particularly women and youth, as well as tackling diseases that solely or disproportionately impact on poor countries.

5.121 Malaria kills one million people every year, 750,000 of them African children under five. Recent positive results with field trials and other research suggest that a licensed vaccine could potentially be ready in three to four years time. In order to speed up progress, the UK Government is ready, working with other Governments, to enter into legally binding contracts to buy a fixed quantity of vaccines at an agreed price. Such *advanced purchase agreements,* which are only binding if the vaccines are successfully developed, will encourage pharmaceutical companies to invest in research with confidence that there will be a market for their products and can ensure that the vaccine will be available at affordable prices.

5.122 With AIDS killing three million people every year and threatening to wipe out decades of progress in the developing world, developing an AIDS vaccine is clearly of critical importance. The UK will explore the use of advance purchase agreements to create the right incentives for pharmaceutical companies, while also recognising the need for direct investment in research as it is still at an early stage. As an example of an area where the returns to investment are potentially very high – with early research suggesting that for every year we bring forward the discovery of an AIDS vaccine, two million lives would be saved – this would be a priority for spending through the IFF and the UK will work with our international partners to increase the resources available. The UK will continue to support work on other HIV prevention approaches, in particular developing microbicides. In addition, the Government recognises the importance of coordinating research efforts and, as agreed by the G8 at the 2004 Sea Island Summit, will push forward with the establishment of the Global HIV Vaccine Enterprise – a virtual consortium to accelerate research into vaccine development through enhancing coordination, information sharing and collaboration globally.

Post-conflict support for Iraq

5.123 The UK's commitment to find a fair and sustainable solution to Iraq's debt was achieved in November 2004, when the Paris Club of creditor countries agreed to forgive 80 per cent of Iraq's external debts. The residual debt was rescheduled on generous terms. The UK's share of this debt relief amounts to approximately $1.4 billion. Full implementation of the Paris Club deal and comparability of treatment from non-Paris Club creditors should deliver approximately $100 billion of debt reduction to Iraq. The UK continues to work alongside its international partners, including the United Nations and the International Financial Institutions, to support the reconstruction of Iraq. The UK supported the agreement in September 2004 of a $436 million IMF Emergency Post-Conflict Assistance programme for Iraq. Through DFID's programmes in Iraq, the UK is working to strengthen the capacity of Iraqi government institutions, including fiscal and economic policy-making capacity within the Ministry of Finance.