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TAX FORCE ™

post election budget 2010

THE POST ELECTION BUDGET 2010

George Osborne presented his first Budget on Tuesday 22 June 2010.

For the first time, forecasts were published in advance of the Budget. The Office for Budget Responsibility was formed in May 2010 to make an independent assessment of the public finances and the economy in advance of each Budget and Pre-Budget Report.

Within the framework of these forecasts George Osborne stated that a tough but fair Budget was needed. Many fundamental announcements have been made which affect the taxation of most individuals. These are in addition to changes already made by the previous government, such as the 50% tax rate and changes to the tax relief available for pension contributions.

Our summary focuses on the issues likely to affect you, your family and your business. To help you decipher what was said we have included our own comments.

If you have any questions please do not hesitate to contact us for advice.

PERSONAL TAX

The personal allowance

For those aged under 65 the personal allowance will be increased by £1,000, from £6,475 to £7,475 for 2011/12.

Comment

By increasing the personal allowance by £1,000 the government states that 880,000 people will be taken out of tax altogether.

However, there was no mention of a transferable personal allowance for married couples/civil partnerships.

For 2010/11 onwards those with adjusted net income over £100,000 have their personal allowance withdrawn by £1 for every £2 of adjusted net income above the income limit. Adjusted net income for these purposes is broadly all income after adjustment for pension payments, charitable giving and relief for losses.

Tax rates

There are no changes announced to the main rates of tax for the current or future years. In particular, the new 50% rate (42.5% for dividends) remains for those with taxable income above £150,000.

To ensure that the majority of higher rate taxpayers will pay the same total level of income tax and National Insurance Contributions (NICs) as previously planned, the government will reduce the basic rate limit by £2,500, and the upper earnings and profits limits for NICs by £1,650, based on current estimates of the Retail Prices Index. These changes will take effect for 2011/12.

The existing basic rate limit is £37,400. The exact figure of the basic rate limit for 2011/12 will be confirmed in the autumn.

The higher rate threshold (the point at which 40% tax begins to be paid) will remain frozen until 2013/14.

Trust rate

For 2010/11, the trust rate, which mainly applies to discretionary trusts, was increased from 40% to 50% and the trust dividend rate from 32.5% to 42.5% and these changes remain.

National Insurance Contributions (NICs)

The NIC rates and limits were broadly frozen for 2010/11 at the 2009/10 figures.

Changes to the rates of NIC and thresholds are proposed from April 2011. As announced by the previous government the NIC primary threshold (the point at which NICs are payable) will increase and a further 1% will apply to the rates applicable to employers, employees and the self-employed. The main rate of Class 1 (employee) NIC will be 12% and the Class 4 rate will be 9%. The employer rate will increase to 13.8%. The additional rate of Class 1 and 4 contributions payable will be increased from the current 1% to 2%.

The upper earnings limit and the upper profits limit will continue to be aligned with the income tax higher rate threshold (which is being reduced in April 2011).

The government will introduce two measures for employers:

- the level at which employers start to pay NICs will increase by £21 per week above indexation from April 2011
- a three-year scheme will be introduced to exempt new businesses in targeted regions from up to £5,000 of Class 1 employer NICs, for each of the first ten employees hired in their first year of business.

Comment

Whilst the government needs the additional income from the rise in the NIC rates, there is a clear attempt to avoid a 'jobs tax'. In addition, there is an intention to prevent those on low incomes from suffering from the NIC rises.

Tax credits

A whole series of changes are announced to the tax credits system. From April 2011:

- the second income threshold for the family element of the Child Tax Credit will reduce from £50,000 to £40,000
- the first and second withdrawal rates for tax credits will increase to 41%
- the baby element will be removed from the Child Tax Credit and, from April 2012, the 50 plus element will be removed from the Working Tax Credit
- the level of in-year rises of income that will be disregarded from calculations of tax credit entitlement will decrease from £25,000 to £10,000 and, from April 2013, this will be reduced to £5,000.

In April 2011, the child element of the Child Tax Credit will increase by £150 above indexation and, in April 2012, it will increase by £60 above indexation.

From April 2012:

- the period for which a tax credit claim and certain changes of circumstances can be backdated will be reduced from three months to one month

- a disregard of £2,500 will be introduced in the tax credits system for in-year falls in income.

Comment

Tax credits were a core feature of the previous government's strategy for helping low income families. Whilst the new government wishes to continue with the principle:

'Spending on tax credits has increased from £18 billion in 2003 to £30 billion this year. This is unsustainable.'

Child Benefit

From April 2011, both rates of Child Benefit will be frozen for three years.

Comment

There had been much discussion whether Child Benefit would survive, particularly for those on higher incomes.

Removal of higher rate relief for pension contributions from 6 April 2011

Some time ago the Labour government announced its intention to remove higher rate relief on the pension contributions of those with high income, broadly £130,000 or more.

This announcement has led to complex rules being introduced from April 2011 onwards, with even more complicated anti-forestalling rules for the years 2009/10 and 2010/11.

Whilst there are no changes to the rules for 2009/10 and 2010/11, the government is looking at simpler ways of achieving a similar result from 2011 via consultation with interested parties.

Provisional research suggests an annual allowance in the region of £30,000 - £45,000 might deliver the necessary tax yield. Relevant issues for the government to consider include:

- options to ensure that basic rate taxpayers are not subject to the restriction and to support cases caused by one-off 'spikes' in pension accrual
- how pension accrual in defined benefit schemes would be valued
- whether and how there could be flexibility for individuals over paying any charges that arise
- how compliance and delivery would operate in practice.

Requirement to buy an annuity

From April 2011 the rules that create an obligation to purchase an annuity by age 75 will be replaced with age 77. A consultation on the detail of this change will be launched in the near future.

Furnished Holiday Lettings

The tax treatment of Furnished Holiday Lettings (FHL) has been advantageous for many years. Provided that certain conditions are met, FHL are treated as a trade. This can be preferable to the tax regime for normal let property in a number of specific areas, as the rules and reliefs for trades are often more generous.

The government has announced that these rules will continue unchanged for 2010/11, with a consultation into possible future changes starting in the summer.

BUSINESS TAX

Corporation tax rates

The main rate of corporation tax which generally applies to companies with profits of more than £1.5 million is to reduce from 28% to 27% from 1 April 2011. There will be further graduated reductions so that the main rate will be 24% by 1 April 2014.

The small profits rate of corporation tax which generally applies to companies with up to £300,000 of profits is to reduce to 20% also with effect from 1 April 2011.

The effective marginal corporation tax rate for profits between £300,000 and £1.5 million is expected to be 28.75% from 1 April 2011 (assuming there is no change to the basis upon which the marginal relief calculation is computed).

Comment

The Chancellor stated that there is to be reform of corporation tax over a five year period to promote UK competitiveness. These headline rate reductions are an initial step towards this goal. The previous government had intended to increase the small profits rate of corporation tax from its current rate of 21% to 22%.

Capital allowances on plant and machinery

Two key areas of change to capital allowance rates are to take effect from April 2012.

The first measure will reduce the maximum Annual Investment Allowance. This is available to most businesses and provides immediate 100% tax relief on the purchase of qualifying plant and machinery. The allowance is currently £100,000. It is to decrease to £25,000.

The second measure reduces the rates of writing down allowances per annum on expenditure not relieved by other allowances as follows:

- from 20% to 18% on expenditure allocated to the main plant pool
- from 10% to 8% on expenditure allocated to the special rate pool.

Transitional rules will apply for chargeable periods which span 1 April 2012 for businesses within the charge to corporation tax and 6 April 2012 for businesses within the charge to income tax.

Comment

The delayed start date for the proposed reduction in capital allowances from April 2012 makes sense as it will help to offset the loss of corporation tax revenue to the Exchequer when the reduction in corporation tax rates kicks in.

Consortium Relief

Those aspects of corporation tax group relief rules that cover consortium relief will be amended to allow EU and EEA-resident companies engaged in UK consortia to pass on relief for the losses of those consortia to their UK resident group companies. At the same time, the government is strengthening rules designed to ensure that access to consortium relief is given only in proper proportion to the member company's involvement in the consortium. Legislation will be in the Finance Bill and both changes will have effect from the day on which draft legislation is published.

Income tax deducted at source

Current rules require certain persons (mainly individuals and unincorporated bodies) to deduct income tax at source on certain payments such as interest and patent royalties and to then pay it over to HMRC. A change to HMRC powers is proposed to enable regulations to be made relating to when and how such a person should remit and report the payment.

Previous announcements to go ahead

The following proposals announced by the previous government are to be implemented:

- the introduction of a new 100% first year allowance for capital expenditure on new zero-emission goods vehicles for expenditure incurred on or after 1 April 2010 and before 1 April 2015 for companies and on or after 6 April 2010 and before 6 April 2015 for unincorporated businesses.
- the removal of the condition that required intellectual property derived from research and development expenditure to be owned by the small and medium enterprise company seeking the tax relief claim. The change will have effect for any expenditure incurred in an accounting period ending on or after 9 December 2009.

Small business tax

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

CAPITAL GAINS TAX

Capital gains tax (CGT) annual exemption

Despite rumours that the annual exemption might change for 2010/11, it remains at the level set previously (£10,100).

CGT rates

Legislation will be included in Finance Bill 2010 to introduce a new rate of CGT of 28%. For individuals, the rate of CGT remains at 18% where total taxable gains and income, after taking into account all allowable deductions including losses, personal allowances and the CGT annual exemption, are less than the upper limit of the income tax basic rate band (£37,400). The new 28% rate will apply to gains or any parts of gains above this limit.

Where Entrepreneurs' Relief applies for individuals or trustees the rate remains at 10%.

The new rate of CGT will apply from 23 June 2010.

Gains arising in 2010/11, but before 23 June 2010, will continue to be liable to CGT at 18% and will not be taken into account in determining the rate(s) at which gains of individuals arising on or after 23 June 2010 should be charged.

Gains on disposals before 23 June 2010 which have been deferred until 23 June 2010 or later under certain CGT reliefs (eg gains deferred under the Enterprise Investment Scheme) will be liable to CGT at the time the deferral period ends. The gain becomes liable to tax in the same way as gains arising on disposals on or after this date at either 18% or 28%.

In working out the CGT due, taxpayers will be able to deduct losses and the annual exemption in the way which minimises the tax due.

Example

In 2010/11 David's taxable income, after all allowable deductions and the personal allowance, is £27,400. The upper limit of the income tax basic rate band is £37,400. David has the following capital transactions:

- May 2010 he sells an asset and realises a chargeable gain of £17,000.
- November 2010 he sells another asset, realising a chargeable gain of £25,100.

David has no allowable losses to set against these gains, and the annual exemption for 2010/11 is £10,100. Neither of the gains qualify for Entrepreneurs' Relief.

David's taxable income is £10,000 less than the upper limit of the basic rate band (£37,400 - £27,400).

David sets the annual exemption against the later gain (because part of that gain is liable to tax at the higher CGT rate), which leaves £15,000 taxable (£25,100 – £10,100). The first £10,000 of the £15,000 is taxed at 18% and the remaining £5,000 is taxed at 28%.

The £17,000 chargeable gain David realised in May 2010 before the change of rates on 23 June 2010 is taxable at 18%.

Trusts

For trustees and personal representatives of deceased persons, the CGT rate will be 28% for gains arising on or after 23 June 2010, except where Entrepreneurs' Relief applies.

Entrepreneurs' Relief

Subject to a number of conditions, gains on disposals of entrepreneurial businesses by individuals and certain trustees qualify for Entrepreneurs' Relief. The relief is given by reducing the qualifying gains by 4/9 and the balance is then charged at an 18% rate of tax. This results in the qualifying gains being taxed at an effective rate of 10%.

The changes to the CGT rates from 23 June 2010 would mean that the 4/9 reduction no longer achieved an effective rate of 10%. Finance Bill 2010 will include provisions to charge gains on qualifying disposals on or after 23 June 2010 at a 10% rate of tax. The previous 4/9 reduction will cease to apply from this date.

Finance Bill 2010 will include provision to increase the amount of gains that can qualify for Entrepreneurs' Relief to £5 million (previously £2 million) from 23 June 2010.

Where individuals or trustees make qualifying gains above the previous £2 million limit before 23 June 2010 (£1 million before 6 April 2010) no additional relief will be allowed for the excess above the old limit. If they make further qualifying gains on or after 23 June 2010, they will be able to claim relief on up to a further £3 million of those additional gains (or up to £4 million where the earlier £1 million limit applied), giving relief on accumulated qualifying gains up to the new limit of £5 million.

In determining at what rate(s) an individual should be charged to CGT on any other gains, those gains qualifying for Entrepreneurs' Relief are set against any unused basic rate band before non qualifying gains.

Comment

The increase in the Entrepreneurs' Relief limit to £5 million was unexpected but welcome.

VAT AND OTHER MATTERS

VAT: change of standard rate

It is proposed to increase the standard rate of VAT from 17.5% to 20% with effect for any supply made on or after 4 January 2011. The rate change does not affect either zero-rated supplies nor those supplies subject to VAT at the 5% reduced rate.

Comment

An increase in the standard rate was widely forecast. Unsurprisingly, draft legislation has also been issued setting out anti-avoidance measures to deal with transactions aimed at forestalling the increase in rate.

VAT Flat Rate Scheme

The VAT Flat Rate Scheme simplifies VAT for businesses with an annual turnover (VAT exclusive) of up to £150,000. The percentages used in the scheme will change from 4 January 2011 to reflect the increase in the standard rate of VAT.

VAT: detailed changes

As previously announced changes will be made early next year to:

- the VAT recovery on mixed use assets
- the place of supply rules for natural gas, heat and cooling
- the definition of aircraft that can be supplied at zero rate
- certain postal services provided by Royal Mail.

Tackling tax avoidance

The government will take a more strategic approach to the risk of avoidance to prevent increasing complexity and reduce the need for frequent legislative change. In this context, the government is tackling long-standing avoidance risks in a way that makes it clear what result the legislation intends to achieve.

The government intends to examine whether the option of a General Anti-Avoidance Rule should form one element of its strengthened defences.

The government will also continue to shut down avoidance schemes as they emerge.

Inheritance tax (IHT)

The government will consult on bringing IHT on trusts within the Disclosure of Tax Avoidance Schemes regime.

Bank levy

A bank levy based on banks' balance sheets will be introduced, following consultation, effective from 1 January 2011. It is proposed that the levy will be set at a rate of 0.07%, with a lower initial rate of 0.04% in 2011.

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