

Budget Notes (BN)

There were 45 Budget Notes issued yesterday, totalling 107 pages, addressing a wide range of topics. 'Tough but fair' was the theme of George Osborne's first Budget. With no pre-budget warm up there was much speculation on how he would tackle the UK's debt. He split his statement into three main categories: deficit reduction, enterprise and fairness. In simple terms, the Government will look to apply an 80/20 rule on how it will tackle the debt over the next four to five years.

80% of the reduction will be driven by spending reductions including welfare reform savings and 20% from net tax increases. The welfare reforms appear to represent around a third of the spending reductions. These include reforms to housing and disability benefits and the tax credit system, as well as freezing child benefit for the next three years. For the basic state pension, however, the earnings link will be restored from April 2011 with a minimum increase guarantee of 2.5% or in line with inflation if higher.

Headline changes to tax relate specifically to Value Added Tax (VAT) and Capital Gains Tax (CGT) as well as an increase to the income tax personal allowance. While the increase in the personal allowance will benefit those with lower incomes, the higher rate tax threshold will be reduced meaning there is no net benefit for those individuals and potentially may mean more tax payers fall into higher rate income tax going forward. The Government also announced its intention to create an independent Office of Tax Simplification, something which we should all welcome!

Personal taxation

BN20 - Capital Gains Tax: rates and entrepreneurs' relief

The rate of CGT remains at 18% for individuals with total taxable gains and income of less than the upper limit of the income tax basic rate band. Legislation will be included in Finance Bill 2010 to introduce a new rate of CGT of 28%. The 28% rate applies to gains (or any parts of gains) above that limit.

For trustees and personal representatives of deceased persons, the rate is increased to 28% on all gains (previously 18%).

The rate of CGT for gains qualifying for entrepreneurs' relief remains 10%. The lifetime limit on gains qualifying for entrepreneurs' relief is increased from £2 million to £5 million.

The annual exempt amount (AEA) for 2010/11 remains at £10,100.

Current law and proposed revisions - rates of CGT

At present section 4 of the Taxation of Chargeable Gains Act 1992 (TCGA) provides that net gains chargeable to CGT (after deduction of reliefs, losses and the CGT AEA) are taxed at 18%.

Finance Bill 2010 will include provisions to change the rates of CGT for gains arising on or after 23 June 2010.

For individuals, where their total taxable income and gains after all allowable deductions (including losses, the income tax personal allowance and the CGT AEA) are less than the upper limit of the basic rate income tax band (£37,400 for 2010/11), the rate of CGT will be 18%. For gains (and any parts of gains) above that limit the rate will be 28%.

For trustees and personal representatives of deceased persons, the rate will be 28%. 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 (or rates) at which gains of individuals arising on or after 23 June 2010 should be charged.

Certain CGT reliefs allow gains on disposal of an asset to be deferred until some time after the disposal. For instance, a gain can be reinvested in shares under the Enterprise Investment Scheme (EIS) and, subject to conditions, can be deferred until the EIS shares are disposed of. The CGT rate(s) on a gain deferred in this way will be the rate(s) at the time the deferral ends and the gain becomes liable to tax. Gains on disposals before 23 June 2010 which are deferred until 23 June 2010 or later will therefore be liable to CGT at 18% or 28%, in the same way as gains arising on disposals on or after that date.

In working out the CGT payable, tax payers will be able to deduct losses and the AEA in the way which minimises the tax due.

Entrepreneurs' relief - rate of CGT and lifetime limit on relief

Subject to satisfying certain conditions, including the lifetime limit of £2 million, gains on disposals of entrepreneurial businesses by individuals and certain trustees qualify for entrepreneurs' relief (Chapter 3 of Part 5 of TCGA). Currently entrepreneurs' relief reduces qualifying gains by 4/9 and the remaining 5/9 are then charged at the single 18% rate. This results in qualifying gains being taxed at an effective rate of 10%.

The changes to CGT rates from 23 June 2010 would mean the 4/9 reduction no longer achieved an effective rate of 10%. Finance Bill 2010 will therefore include provision to charge gains on disposals that qualify for entrepreneurs' relief on or after 23 June 2010 at a 10% rate. The previous 4/9 reduction will cease to apply from that date.

The amount of an individual's gains that can qualify for entrepreneurs' relief is subject to a lifetime limit of £2 million (£1 million for disposals before 6 April 2010). For trustees, the £2 million limit is that of the beneficiary of the settlement who meets the conditions for the trustees to claim the relief.

Finance Bill 2010 will include provision to increase that limit to £5 million from 23 June 2010.

Where individuals or trustees make qualifying gains above the previous £2 million limit before 23 June 2010 (£1 million limit before 6 April 2010), no additional relief will be allowed for the excess above the old limit. But 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.

BN22 - Measures deferring the effective requirement to buy an annuity

The Government has announced that it will end the effective requirement to use a pension fund to buy an annuity by age 75 with effect from 2011/12. Pending implementation of the necessary changes, legislation will be introduced in Finance Bill 2010 to increase to 77 the age by which members of registered pension schemes have to buy an annuity or otherwise secure a pension income. This change will also apply for the purposes of the inheritance tax (IHT) charges that specifically apply to pension scheme members aged 75 and over.

The increase in the age by which the member must secure an income has effect on and after 22 June 2010. This change will also apply for IHT purposes to members, who die on or after that date. In both cases the change applies only to individuals, who have not yet reached age 75 before 22 June 2010. For scheme members with money purchase arrangements who have not yet bought an annuity by age 75, the income withdrawals they may make currently become subject to strict minimum and maximum limits from age 75. Also, if such a member dies after reaching age 75 and any of the fund is not used to pay either pensions to dependants or a charitable donation, it is subject to tax charges up to 70%. Specific IHT

charges also apply to certain pension scheme members who die on or after their 75th birthday.

For scheme members with money purchase arrangements who have not yet bought an annuity and reach age 75 on or after 22 June 2010:

- the strict minimum and maximum limits on income withdrawals will apply from their 77th instead of their 75th birthday;
- immediately before their 75th birthday they will become entitled to income withdrawal and a tax free pension commencement lump sum in respect of those funds not previously made available for income withdrawal; and
- in the interim period before the main changes have effect in 2011-12, there will be tax charges of 35% on lump sum death benefits paid by the scheme if they die on or after 22 June 2010 and aged 75 or over. The specific IHT death charges on pension scheme members, who are in drawdown and are aged 75 or over when they die, will not apply in these circumstances. Previously there could have been tax charges up to 82% of the value of the drawdown fund.

Pensions tax relief

The Government is committed to restricting the amount of tax relief applied to pensions. However, they have reservations regarding the complexity surrounding the High Income Excess Relief charge. From April 2011 this introduces a tapered tax charge for those with incomes in excess of £150,000 resulting in those with incomes above £180,000 receiving tax relief at the basic rate.

The Government will include in Finance Bill 2010 powers to repeal the legislation introducing this charge. The Government will consult on alternative measures to restrict pensions tax relief from 6 April 2011 by reforming existing pension tax allowances, principally through a reduced annual allowance. The suggestion is that to deliver the necessary savings, the annual allowance would be in the range of £30,000-£45,000.

BN43 - Change to standard rate of VAT

Legislation will be introduced in Finance Bill 2010 to increase the standard rate of VAT from 17.5% to 20%. The 20% rate will have effect for any supply made on or after 4 January 2011 and any acquisition or importation taking place on or after that date. Zero-rated supplies, such as basic foodstuffs, childrens' clothing and books; exempt supplies, such as education and health; and supplies subject to VAT at the 5% reduced rate, such as domestic fuel and power, are not affected by this change.

Anti-forestalling legislation and changes to the VAT flat rate scheme will also be introduced as a result of this measure. Changes to the payment on account regime thresholds will be made at a later date to maintain the status quo of the scheme.

BN01 - The personal allowance, basic rate limit and national insurance thresholds for 2011/12

Income tax and national insurance contributions (NICs) changes for income tax payers, employers, employees and the self employed for tax-year 2011/12, taking effect on and after 6 April 2011, are as follows:

- The personal allowance for those aged under 65 will be increased by £1,000 to £7,475.
- The basic rate limit will be reduced so that higher rate taxpayers do not benefit from the increase in the personal allowance.
- The alignment of the Upper Earnings/Profits Limit (UEL/UPL) with the higher rate threshold will be maintained by reducing the UEL/UPL.
- The secondary threshold, which is the point at which employers start to pay Class 1 NICs, is to be increased by an extra £21 per week above indexation.

Some of these figures will depend on September's RPI, and therefore the precise amounts will be announced later in the year following publication.

BN21 - Indexation of ISA subscription limits from 2011/12

This BN confirms the measures previously announced at Budget 2010. From 2011/12 the ISA allowance will increase each year from the current £10,200 limit in line with RPI. Increases will be rounded to £120 and if RPI is negative the ISA limit will remain unchanged.

BN25 - Income Tax adjustments between settlors and trustees

This measure was previously announced at Budget 2010 and a version of this note was published as BN30. Settlor (people who set up a trust) may receive repayments of tax on trust income if they are liable to income tax at a lower rate than the trustees. This measure will require settlors to pay any such repayments of tax they receive to the trustees. The result of this will be that these payments to trustees will be disregarded for IHT purposes.

The measure will have effect for repayments relating to trust income that arises on or after 6 April 2010.

Corporate taxation

BN02 and BN03 - Corporation tax rates

Legislation will be introduced in Finance Bill 2010 to set the rates of corporation tax as follows:

- The main rate of corporation tax for companies with profits above the upper limit (£1.5 million) will be set at 27% and will be effective on and after 1 April 2011. (This reduces the rate set by Section 2 of the Finance Act at 28% on or after 1 April 2011, for companies with profits other than ring fence profits.)

Note: There will be further reductions to 24% by 1 April 2014.

- The small profits rate of corporation tax for companies (that are not a closed investment-holding company) with profits below the lower limit (£300,000) will be set at 20% and will be effective on or after 1 April 2011. (This reduces the rate set by Section 3 of the Finance Act at 21% on or after 1 April 2011, for companies with profits other than ring fenced profits.)

BN04 - Capital allowances: rate and annual investment allowance changes

Legislation will be introduced in a future Finance Bill to make changes to capital allowances. As part of the overall package of reducing headline corporate tax rates, the rates of writing-down allowances (WDAs) for new and unrelieved expenditure on plant and machinery will move:

- from 20% to 18% per annum for expenditure allocated to the main rate pool; and
- from 10% to 8% per annum for expenditure allocated to the special rate pool.

This measure will have effect for the calculation of WDAs for chargeable periods ending on or after 1 April 2012 for businesses within the charge to corporation tax and on or after 6 April 2012 for businesses within the charge to income tax.

Details of the transitional arrangements will be published, along with draft legislation in due course.

BN16 - Corporate investors in Authorised Investment Funds (AIFs)

Two new measures are being introduced from today that will ensure the streaming of distributions from AIFs received by corporate investors accurately reflects the deemed tax attached to the distribution. The aim is to prevent a corporate investor using an AIF to create a credit for UK tax where no UK tax has actually been paid.

The corporation tax deduction for interest distributions will be restricted so that it only applies to that part of the distribution that is derived from dividends exempt from corporation tax (the 60/40 rule means that part of an interest distribution from an AIF can be derived from dividend payments arising from the underlying investments). The second amendment is that the tax deduction for distributions arising from foreign income will be restricted so that it only applies to that part of the distribution that is treated as a foreign tax credit (and that the balance will be treated as taxable foreign income).

These changes could make the tax calculation for income received by corporate investors more complex. They may also result in a greater proportion of income derived from fixed interest and non-UK equity collectives being liable to corporation tax.

Summary

I hope you find this summary useful. As ever, the need for advice on these issues will be critical for clients to fully understand the impact of the changes. Please get in touch with Jim Cooper on 01628 762694 if you wish to discuss any aspect in further detail.