Technical Connection

BUDGET ISSUE

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INCOME TAX

TAX RATES (2009/10)

(i) The starting rate of 10% will apply to the first £2,440 of taxable **savings income** (i.e. after allowances and reliefs). This means that if an individual's non-savings income is more than £8,915 (the standard personal allowance of £6,475 plus the 10% band of £2,440) then the 10% starting rate will not apply. The non-savings income of £2,440 which absorbs the 10% band would be taxed at 20%.

The basic rate of income tax is held at 20% and the higher rate threshold has been increased to £37,400. The basic rate of tax will apply to income in the band £1 to £37,400.

(ii) The dividend rates remain at 10% and 32½%, with the 10% rate applying to income in the £1 - £37,400 basic rate band.

PERSONAL ALLOWANCES (2009/10)

Personal allowances and the age allowance threshold are as follows:

- Standard personal allowance £6,475

- Age allowance £9,490 (for those aged 65-74) and £9,640 (for those aged 75 and over)

- The level of total income that a person can enjoy before age allowance is cut back is £22,900

- The married couple's allowance (MCA) for those aged 75 and over is £6,965 (provided at least one spouse was aged 65 or over before 6 April 2000). The MCA for those aged 65 to 74 is no longer relevant for tax year 2009/10 and beyond.

- In calculating the reduction in age allowance when total income exceeds £22,900, the MCA is cut back to not less than £2,670 (the "minimum amount").

TAX RATES (2010/11)

(i) It was announced that from 6 April 2010 the rate of tax payable on taxable income in excess of £150,000 will be 50%. This brings forward and increases the 45% rate which had been proposed in the 2008 Pre-Budget Report to apply from 6 April 2011.

(ii) From 6 April 2010 dividends received by individuals will be taxed according to the tax band in which they fall as follows:

Basic rate band	10%
Higher rate band	32.5%
50% band	42.5%

PERSONAL ALLOWANCES (2010/11)

From 6 April 2010, where an individual's "adjusted net income" exceeds £100,000, the level of the personal allowance will be reduced by £1 for each £2 over £100,000 until it reaches zero.

This potential reduction in the personal allowance is harsher than the previously proposed change in the 2008 Pre-Budget Report which would have resulted in a £1 for £2 cut off for gross income over £100,000 but restricted to the loss of half of the personal allowance. The remaining one-half of the personal allowance would have been reduced by £1 for every £2 of gross income above £140,000.

Adjusted net income is calculated in a series of steps. The starting point is "net income" which is the total of the individual's income subject to income tax less specified deductions, the most important of which are trading losses and payments made gross to pension schemes. This net income is then reduced by the grossed-up amount of the individual's Gift Aid contributions and the grossed-up amount of the individual's pension contributions which have received tax relief at source. The final step is to add back any relief for payments to trade unions or police organisations deducted in arriving at the individual's net income.

OVERSEAS DIVIDENDS

Last year's Budget made changes to the treatment of overseas dividends received by individuals. This briefly opened up a loophole which would have allowed investors to earn overseas interest free of basic rate tax. However, the Treasury spotted their error – after the press had highlighted it – and inserted an appropriate anti-avoidance clause into the Finance Bill 2008. In 2009, the Chancellor revisited the issue.

From 22 April 2009, individual shareholders with 10% or more shareholdings in a non-UK resident company will generally receive the same treatment as investors with smaller holdings, i.e. dividends from the foreign company will be deemed to be accompanied by a non-payable 10% tax credit. The foreign company must be resident in a country which has a double taxation agreement with the UK, with a non-discrimination article.

OFFSHORE FUNDS

This Budget has made a sensible change to the treatment of offshore fund distributions. For income payments from offshore funds made to individuals on or after 22 April 2009:

- If the fund is an equity fund, then the distribution will be accompanied by a 10% non-payable tax credit. A basic rate taxpayer will therefore have no further tax liability. For a higher rate taxpayer, the additional tax liability will be 25% of the dividend received (ie. 32.5% of the grossed-up dividend).

- If the fund is not an equity fund, the distribution is classed as an interest payment with no attaching tax credit. A fund is not an equity fund if, broadly, it holds more than 60% of its assets in interest bearing securities, cash deposits and similar investments. So in these cases the investor who is a higher rate taxpayer will pay 40% tax on the distribution.

Before these changes, all distributions from offshore funds were treated as dividends, but with no attaching tax credit. The reforms therefore *reduce* the amount of tax that will have to be paid on equity fund dividends, but increase tax payable on non-equity fund income. The overall effect is to bring tax on offshore fund income payments largely into line with that of their onshore counterparts.

FURNISHED HOLIDAY LETS

In a surprise move, hidden deep in the Budget documentation, the Chancellor announced that the furnished holiday lettings legislation would be repealed from 2010/11. A clue to why this move was made can be found in the fact that for 2009/10 the rules will be extended to include qualifying lettings throughout the European Economic Area.

INCOME SHIFTING

The controversial subject of "income shifting" received a brief mention, with a reminder that the government is keeping the matter "under review".

COMPANY CARS

The company car benefit scales remain unchanged for 2009/10. The next adjustment will take place in 2010/11, when there will be a 5g/km decrease to 130g/km for the lower threshold (15% for petrol). This will be followed in 2011/12 by a further threshold reduction to 125g/km and the abolition of all the current scale-rate reductions for alternatively-fuelled cars (eg LPG), other than for electric-only vehicles.

The multiplier for calculating car fuel benefit in 2009/10 was left at £16,900, in spite of the substantial falls in petrol and diesel prices over the last year. According to the AA, the average UK price in April 2008 was 108.1p a litre for petrol and 117.4p for diesel.

OFFSHORE DISCLOSURE – SECOND CHANCE

HMRC will operate a new disclosure opportunity that will run until March 2010. Holders of offshore accounts will be given the opportunity to disclose (and pay) any unpaid tax or duties. Details of penalty charges have yet to be confirmed.

A number of offshore centres have recently signed new exchange of information treaties with the UK, which HMRC probably hopes will encourage some reconsideration by those who ignored the original offshore disclosure window in the first half of 2007.

CAPITAL GAINS TAX

Major changes to the taxation of capital gains for individuals and trustees took place from 6 April 2008. The main change in this Budget was the increase in the annual exemption to £10,100 in 2009/10 for individuals and personal representatives, and (in most cases) £5,050 for trustees. The rate of tax for individuals, personal representatives and trustees continues at the flat rate of 18%.

A change of less wide application was that removing transparency in respect of chargeable capital gains made by offshore funds that are not constituted as companies, unit trusts or partnerships. Such funds are understood to be mostly based on contractual relationships.

INHERITANCE TAX

- As announced in earlier Budgets, the nil rate band has been increased from £312,000 to £325,000 and applies to chargeable transfers occurring on or after 6 April 2009. The Chancellor estimated that only 2% of estates will be subject to IHT in 2009/10 (compared with 5% in 2008/09).

- The Chancellor announced that the availability of agricultural property relief and woodlands relief would be extended to agricultural property and woodlands situated in the European Economic Area. The change is effective from 22 April 2009 and earlier in certain circumstances. Specialist advice should be taken in this area.

CORPORATION TAX

The rates of corporation tax for the financial year starting 1 April 2009 are as follows:-

- The small companies' rate of corporation tax is held at 21% and applies where a company has profits of up to £300,000. The small companies' rate remains set to rise to 22% from 1 April 2010.

- The main rate of corporation tax is held at 28% and continues to apply to profits of a company of more than £1,500,000.

- Between £300,001 and £1,500,000 marginal rate relief applies. This operates to increase the overall rate of tax on the profits to somewhere between the small companies' rate of 21% and the main rate of 28%. Profits in excess of £300,000 will effectively bear tax at the marginal rate of 29.75%.

NATIONAL INSURANCE

Rates for 2009/10

The National Insurance rates and contribution limits announced in the 2008 Pre-Budget Report apply as follows:-

- The employee's Primary Class 1 National Insurance rate is 11% on earnings between the Primary Threshold (£110 per week) and Upper Earnings Limit (£844 per week).

- Employees, in addition, pay 1% Primary Class 1 National Insurance on all earnings above the Upper Earnings Limit.

- The Employer's Secondary Class 1 contribution rate on earnings above the Secondary Threshold (£110 per week) is 12.8%.

- The self-employed Class 4 rate on profits between the lower (£5,715 pa) and upper profits limit (£43,875 pa) is 8%.

- The self-employed, in addition, pay Class 4 contributions at a rate of 1% on all profits above the upper profits limit (£43,785).

- The self-employed Class 2 flat rate contribution is £2.40 per week and the exemption limit is £5,075.

- The Class 3 voluntary contribution rate is £12.05 per week.

Changes from 2011/12

Changes, effective from 6 April 2011 and already announced in the 2008 Pre-Budget Report, are as follows:-

- The NICs Primary Threshold will be broadly aligned with the basic personal allowance.

- The main rate of Class 1 and Class 4 NICs will be increased by 0.5% to 11.5% and 8.5% respectively.

- The Class 1 employer rate of NICs will be increased by 0.5% to 13.3%. The increased rate will also apply to Class 1A and Class 1B contributions.

- The additional rate of Class 1 and Class 4 NICs will be increased by 0.5% to 1.5%.

The Upper Accrual Point

Although not introduced in the current Budget, the Upper Accrual Point (UAP) took effect from 6 April 2009.

The 2007 Budget announced a number of changes to the Upper Earnings Limit (UEL) for NI contribution purposes. The UEL was increased by £75 a week above normal indexation on 6 April 2008 and has been given a further above - indexation increase as at 6 April 2009 to £844 per week (see above) to align it with the threshold at which higher rate tax becomes payable, allowing for the single personal allowance.

Prior to tax year 2009/10 S2P benefit has accrued on individuals' earnings between the Lower and Upper Earnings Limits. However, the Government has now capped the earnings for the provision of S2P benefits to the Upper Accrual Point, which will remain permanently fixed at £770 per week.

These changes introduce a sizeable increase in NI contributions.

TAX-FAVOURED INVESTMENTS

ISAs

From 6 April 2009 the annual contribution limit is maintained at £7,200, with the maximum contribution to a cash ISA being £3,600. From 6 October 2009 the maximum contribution for those aged 50 and over in tax year 2009/10 is raised to £10,200, with the maximum contribution in cash being £5,100.

From 6 April 2010 the new increased limits will apply to all qualifying ISA investors.

The Child Trust Fund (CTF)

Every eligible child born on or after 1 September 2002 has a Child Trust Fund account. Family and friends can contribute up to £1,200 into the account each year.

In this Budget, it is proposed that the Government will make payments of £100 per year into the Child Trust Fund accounts of all disabled children. Severely disabled children (those who receive the High Care element of Disability Living Allowance) will receive £200 per year. These payments will not count towards the £1,200 yearly contribution limit.

Enterprise Investment Scheme

Currently an investor may carry back income tax relief to the previous tax year by claiming that qualifying shares are treated as having been issued in the previous tax year. This is restricted to shares issued before 6 October and subject to a limit of half of the subscriptions in that period, up to an overall limit of £50,000 subscribed. The Finance Bill 2009 will remove these restrictions. The total investment that can be taken into account for the purposes of calculating income tax relief for any particular tax year will remain subject to the current limit of £500,000.

Tax elected funds

Under current rules, UK Authorised Investment Funds (AIFs) are normally chargeable to corporation tax on taxable, ie. non-dividend, income at a special rate of 20 per cent.

That will remain the case under the new regime, but UK AIFs that meet certain conditions will be able to elect to be treated as a tax elected fund (TEF). TEFs will be required to make two types of distribution of the income they receive - a dividend and a non-dividend (interest) distribution. UK dividend income will remain non-taxable in the fund and will be distributed as a dividend. For all other income that is distributed as a non-dividend distribution (ie. an interest distribution), the fund will receive a tax deduction up to the same amount. The new regime will be introduced by secondary legislation.

UK investors are treated as receiving UK dividend income (including the non-payable dividend tax credit) and a payment of yearly interest in the appropriate proportions.

TRUST TAXATION

In the Pre-Budget Report in November 2008, the Chancellor announced that the trust tax rate would increase to 45% with effect from 6 April 2011. In this Budget the Chancellor not only increased the tax rate that will apply to trusts but also brought forward the date of implementation to 6 April 2010.

With effect from 6 April 2010, the 40% trust rate will increase to 50% (with the dividend rate increasing to 42.5% from 32.5%). This is a serious increase for trustees and, unlike the 50%/ 42.5% rates for individuals, it is not restricted to income that exceeds £150,000.

PENSIONS

The Government has announced its intention to restrict the availability of higher rate tax relief on contributions to Registered Pension Schemes with effect from 6 April 2011 for people with taxable income of £150,000 or more. Relief will be tapered away so that for those earning £180,000 and over it is worth 20 per cent, the same as to a basic rate taxpayer. Details of how this tapering will work are to be subject to consultation.

The Government was concerned that individuals likely to be affected by the change in 2011 would pay substantial pension contributions before then and it is therefore introducing what it refers to as "anti-forestalling legislation" in the Finance Bill 2009. This anti-forestalling legislation will apply to pension contributions/pension accrual from 22 April 2009 to 5 April 2011(ie. until the main legislation takes effect in April 2011). The anti-forestalling legislation will restrict higher rate tax relief on pension contributions for individuals on incomes of £150,000 or higher that are in excess of their normal pattern prior to the new regime coming into effect. It will do so by introducing a special annual allowance of £20,000 that applies from 22 April 2009 and an associated tax charge.

The special annual allowance sets an upper limit on the amount of non-regular pension savings for which full tax relief at rates above basic rate can be given. Although all an individual's pension savings will be taken into account in assessing the special annual allowance of £20,000, the special annual allowance tax charge (20% for tax year 2009/10) will only apply to pension savings where all the following circumstances apply:

- The individual has taxable income of £150,000 or more in either the current tax year or in either of the two previous tax years, and

- increases their pension savings from 22 April 2009 beyond their "normal regular amount", and

- The amount of the individual's total pension savings in that tax year are in excess of £20,000.

It should be noted for the above purpose that:

- It is the individual's total taxable income that is taken into account. This includes unearned income and pension income and is his/her total income before pension contributions, personal allowances or any other reliefs or deductions. Any normal deductions for reliefs (such as trading losses) can be made. Deductions can be made for pension contributions but only up to a maximum of £20,000. Deductions may also be made for Gift Aid contributions.

- Any salary sacrifice arrangement entered into on or after 22 April 2009 for the purpose of payment of employer pension contributions will be added to the individual's income when assessing the £150,000 limit.

- An individual's "normal regular amount" is defined as regular contributions to a money purchase scheme being paid, by the member or on their behalf, at a quarterly or more frequent rate prior to 22 April 2009. Where the individual is a member of a final salary scheme their "normal regular amount" is the normal pension accrual under the scheme (ie. N/60ths etc). It will only be any increase in pension savings above these levels that will potentially be subject to the special annual allowance tax charge.

- Although the individual's "normal regular amount" is not assessable itself for the new tax charge, it does reduce the individual's £20,000 allowance as the following example demonstrates. Jane had taxable income of £170,000 in tax year 2009/10. She had been paying personal pension contributions of £1,000 a month prior to 22 April 2009. This represented a "normal regular amount" of £12,000. She had no other pension arrangements. In June 2009 she paid a single contribution of £30,000 to her personal pension. Jane will be subject to a special annual allowance tax charge of £4,400 (ie. 20% x £22,000). Although her "normal regular amount" of £12,000 is not assessable to the tax charge, it does reduce her special annual allowance of £20,000 in 2009/10 to £8,000 and means that £22,000 of her single contribution (£30,000 - £8,000) is taxed at the special annual allowance tax rate of 20%.

- The £20,000 limit will apply to all contributions paid to money purchase schemes in the tax year concerned, irrespective of whether the contributions have been paid by the member, his employer or a third party. When assessing this limit for a member of a defined benefit scheme the normal ten times multiplier will be applied to the increase in the member's pension benefits in respect of the tax year concerned.

The special annual allowance tax charge will be collected via an individual's self-assessment tax return.

Where an individual is subject to an annual allowance charge as well as the special annual allowance charge, the amount subject to the special annual allowance charge will be reduced by the excess over the existing annual allowance to avoid a double tax charge.

Where an individual is subject to the new special annual allowance charge he may be able to seek a refund of his personal contributions. This will be subject to the scheme rules permitting such a refund and the scheme administrator agreeing to the refund. The refund would not be made until the tax year following the tax year in which the contributions were paid. For example, where a refund was made in tax year 2010/11 in respect of personal contributions paid in tax year 2009/10 this would be subject to a tax charge of 40%.

Any "creative" solutions to avoid this may be risky. The draft legislation includes a broad anti-avoidance provision which threatens to catch any arrangement the main purpose, or one of the main purposes, of which is to avoid or reduce liability to the special annual allowance charge…."

LIFE POLICYHOLDER/LIFE COMPANY TAXATION

Life policyholder taxation

Targeted anti-avoidance legislation will be introduced in Finance Bill 2009 to counter certain tax schemes which involve the use of offshore life policies to secure a claim for income tax loss relief.

Draft legislation, published on 1 April, proposes an amendment to section 152 Income Tax Act 2007 (ITA). Section 152 provides for loss relief against "miscellaneous income". For this purpose miscellaneous income includes offshore income gains (ie. gains arising on the disposal of units/shares in offshore non-distributor funds).

Miscellaneous income also includes chargeable event gains arising under policies which fall within section 531(3) Income Tax (Trading and Other Income) Act 2005 (ITTOIA). Such policies are those for which no basic rate tax relief is available on a chargeable event gain because the underlying investment fund has not suffered tax at a rate of at least 20%. These section 531(3) policies are:-

(i) Those forming part of the tax exempt business of a friendly society.

(ii) Offshore policies (ie. policies issued by a non-UK resident life company) other than those which are qualifying policies.

(iii) Annuities paid from a fund which has not been subject to corporation tax.

(iv) An offshore capital redemption policy.

Where, instead of a chargeable event gain, a loss arises on such policies then under section 152 ITA the loss can be set against miscellaneous income in general.

From the explanatory note that accompanies the draft legislation it would seem that losses generated from offshore life policies have been used to avoid tax on offshore income gains.

To prevent what is seen by HMRC as abuse, gains from section 531(3) ITTOIA policies will no longer fall within section 152 ITA with the result that any losses generated by such policies will not be available to support a claim for loss relief against miscellaneous income.

The legislation will apply to all losses arising on or after 6 April 2009. In addition, losses claimed for in previous years which would not be relievable under the new proposed legislation cannot be used after 5 April 2009.

Similarly treated are losses arising in tax year 2008/09 under policies issued on or after 1 April 2009, pre-1 April 2009 policies which are varied on or after that date so as to increase the benefits, and pre-1 April 2009 policies which, on or after 1 April 2009, are assigned to the person claiming relief or used as security for a debt of the person claiming relief

Apparently it is the view of HMRC that such losses have never been relievable but the proposed legislation has been introduced to put the matter beyond doubt.

It is important to note that this change will not impact on deficiency (loss) relief whereby, broadly, a loss arising on a final chargeable event (such as death giving rise to the payment of benefits or full surrender) can be offset against income subject to higher rate tax to secure 20% tax relief. The amount of loss that can be offset in this way is restricted to the amount of any chargeable event gains that have previously arisen under the policy and been assessed on the person now suffering the loss. The purpose of this relief is to relieve gains that may previously have suffered income tax and not to provide relief for investment losses.

Life company taxation

Legislation is be introduced in Finance Bill 2009 to

- Clarify the law relating to the tax treatment of amounts introduced by shareholders into the long-term insurance fund 0f a life insurance company.

- Restrict the Case I deduction for amounts allocated to policyholders in certain exceptional circumstances.

- Clarify the transitional rules governing relief for repayments of contingent loans taxed under section 83ZA of the Finance Act (FA) 1989.

- Amend the rules governing the calculation of the 'floor' for gross roll-up business investment return to ensure consistent treatment of foreign business assets.

- Change the anti-avoidance rules relating to value shifting to ensure that they will not apply when a reduction in value arises as a result of a transfer of long-term insurance business between companies in the same group.

These changes are largely effective from 22 April 2009.

STAMP DUTY LAND TAX

In September 2008 the Chancellor announced a "holiday" from stamp duty land tax (SDLT), which exempted from SDLT any acquisitions of residential property for not more than £175,000. The measure applied to acquisitions between 3 September 2008 and 2 September 2009 inclusive. This increased threshold has now been extended to 31 December 2009.

TRADING LOSSES

The Budget increased the timeframe of the 2008 Pre-Budget Report proposals to extend the carry back of losses for companies and unincorporated businesses. A trading loss may now be carried back for a period of three years, rather than just to the immediately preceding year. Only a maximum of £50,000 may be carried back beyond the immediately preceding year, and then only when profits for that year have been offset in full. These rules apply for company accounting periods ending between 24 November 2008 and 23 November 2010 and for tax years 2008/09 and 2009/10 for unincorporated businesses.

CAPITAL ALLOWANCES

Two important revisions to capital allowances were announced:

- *Cars* A new capital allowance structure based on CO_2 emission levels now applies for cars. For newly acquired cars with emissions of more than 110 g/km up to 160 g/km, there is a 20% writing down allowance, with no cash ceiling. For higher emission cars, the writing down rate is 10%. Cars with emissions of 110g/km or less qualify for 100% first year allowances.

  As a consequence, the special rules that restrict the amount of car lease rental payments that can be deducted for tax purposes have been changed. The restriction is now a flat rate disallowance of 15% of relevant payments and this only applies to cars with CO_2 emissions exceeding 160g/km.

- *New first-year allowance* There is a temporary first-year allowance of 40% for most investment in plant and machinery for one year only from 1 April 2009 for companies and 6 April 2009 for unincorporated businesses. This allowance will apply where investment exceeds the £50,000 100% annual investment allowance and represents a doubling of the standard 20% writing down allowance.

RESIDENCE AND DOMICILE

A number of mostly technical changes were announced to the new non-domicile tax rules introduced from 2008/09. The most significant of these was the removal of the requirement for all individuals employed in the UK to file a self-assessment tax return if they have also received income from overseas employment in the same tax year. For 2008/09 and subsequent tax years there will be no requirement to file a return where:

- overseas employment income is less than £10,000;

and

- overseas bank interest is less than £100 in any tax year;

and

- all of the income is subject to a foreign tax.

THE FINANCE BILL 2009

The Finance Bill was published on Thursday 30 April. The comments in this bulletin are based solely on information made available at the time of the Budget.

As usual, the contents of this bulletin are based on the proposals put forward by the Chancellor in his 2009 Budget and need to be approached with caution as details may change during the passage of the Finance Bill through Parliament.