Technical Connection

BUDGET ISSUE CONTENTS

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INCOME TAX

TAX RATES

(i) The unchanged starting rate of 10% for the tax year 2010/11 applies to the first £2,440 of taxable savings income (i.e. after allowances and reliefs).

(ii) For 2010/11, the basic rate of income tax has been held at 20%. The higher rate threshold remains at taxable income of £37,400. The basic rate of tax will apply to taxable income in the band £1 to £37,400. Taxable income in excess of this will be taxed at 40% or 32.5% (UK dividend income) up to the threshold (£150,000) for the additional rate of 50%.

(iii) It was announced last year that from 6 April 2010 the rate of tax on taxable income in excess of £150,000 would be 50%. It is a little confusing that the new 50% rate is called an "Additional Rate" as this implies that it will be applied "in addition" to some other rate. It will not - it is a stand-alone rate applying to taxable income over £150,000. Dividends received by an additional rate taxpayer will be taxed at 42.5%.

PERSONAL ALLOWANCES

As announced in the 2009 Pre-Budget Report, allowances and thresholds for 2010/11 have been held at their level in 2009/10.

This means:

- The basic personal allowance is £6,475.

  From 6 April 2010, where an individual's "adjusted net income" exceeds £100,000 the level of the basic personal allowance is reduced by £1 for each £2 of income over £100,000 until it reaches zero for an income of £112,950 or more. The result of this restriction is that the band of adjusted net income between £100,000 and £112,950 will be subject to an effective tax rate of 60%.

  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.

- The age allowance is £9,490 (for those aged 65 – 74) and £9,640 (for those aged 75 and over).

- The level of 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 remains at £6,965. In calculating the reduction in age allowance when income exceeds £22,900, the MCA is cut back to not less than £2,670 (the "minimum amount").

- Tax relief for maintenance payments will be available only where at least one party was 65 or over at 5 April 2000. The relief remains based on £2,670.

Relief in respect of the MCA and maintenance payments continues to be given as a tax credit at the rate of 10%.

NATIONAL INSURANCE

Rates for 2010/11

The National Insurance rates and contribution limits announced in the 2009 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 (£43,875 per annum).

- 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 (£43,875).

- The self-employed Class 2 flat rate contribution is £2.40 per week.

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

Changes from 2011/12

Changes, effective from 6 April 2011, already announced in the 2009 Pre-Budget Report are as follows:-

- The main rate of Class 1 and Class 4 NICs will be increased by 1% to 12% and 9% respectively.

- The Class 1 employer rate of NICs will be increased by 1% to 13.8%. 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 1% to 2%.

As announced in the 2008 Pre-Budget Report:-

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

CAPITAL GAINS TAX

- The rate of capital gains tax (CGT) stays at a flat rate of 18%. This now looks something of an anomaly when set against a top income tax rate of 50%. There were some rumours that the Chancellor would raise the capital gains tax rate, but he made a point in his speech that he would not do so. On this occasion there was no increase in the annual exemption, which remains at £10,100 for individuals and up to £5,050 for most trusts.

- There was an unexpected improvement to entrepreneurs' relief, which effectively taxes capital gains on the sale of certain businesses and business-related assets at 10%. The relief was introduced two years ago with a lifetime ceiling of £1m of gains realised after 5 April 2008. From 2010/11 onwards the ceiling is doubled to £2m. Where an individual realised gains of over £1m before 2010/11 there is no retrospective tax reduction, but there will be the benefit of an additional £1m limit going forward. Because this relief operates by way of reducing the gains chargeable to CGT, if CGT rates go up so will the effective rate of tax on gains that qualify for entrepreneurs' relief.

INHERITANCE TAX

The inheritance tax nil rate band was due to rise to £350,000 on 6 April 2010, a measure put in place in 2007. However, in last December's Pre-Budget Report the Chancellor announced that the nil rate band would remain frozen for 2010/11 at £325,000. Indeed, in his Budget statement he went further and announced that the nil rate band would remain at £325,000 until 5 April 2015.

CORPORATION TAX

The rates of corporation tax for the financial year starting 1 April 2010 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 is scheduled to remain at 21% for the financial year starting 1 April 2011.

- 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%. In effect, it means that profits in excess of £300,000 will effectively bear tax at the marginal rate of 29.75%.

INVESTMENTS

Individual Savings Accounts (ISAs)

The most important change on the investment front was the revision of the ISA limits:

- From 6 April 2010 all eligible investors, irrespective of age, will be able to invest £10,200 in an ISA each year. Up to £5,100 of this could be in cash.

- From 2011/12 onwards the investment limits will be increased in line with the RPI. The resultant annual limit will be rounded to the nearer £120, to make the corresponding monthly limits divisible by £10.

As the original ISA investment ceiling was £7,000 in April 1999, the 2010/11 limit is already higher than it would have been if RPI linking had existed from day one (which would have made it about £9,360). ISAs have become a more valuable investment tool, given the new tighter restrictions on pension provision and the introduction of the 50% income tax rate.

Venture Capital Trusts and Enterprise Investment Schemes

The rules for Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EISs) are to be amended. The amendments, to be introduced in the first Finance Bill of the next Parliament, will:

- Change the minimum amount VCTs must hold in eligible shares. At present 'eligible shares' in unlisted companies must represent at least 30% of a VCT's qualifying investments (which in turn have to be at least 70% of the VCT). The eligible shares minimum holding will more than double to 70%.

- Revise the definition of VCT 'eligible shares' to include shares which may carry certain preferential dividend rights.

- Allow a VCT to be listed on any EU/EEA investment market rather than just be restricted to a UK listing.

- Prevent shares in companies that are 'in difficulty' from qualifying for the purposes of the VCT and EIS rules.

- For both EISs and VCTs, change the existing requirement that an EIS company or a company in which a VCT invests must have a qualifying trade carried out wholly or mainly in the UK to one that it need only have a permanent establishment in the UK.

These changes were the subject of a consultation paper issued alongside the 2009 Pre-Budget Report and were expected to come into effect from 6 April 2010. However, the Budget Day press release says that the changes will take effect from Royal Assent of the post-election Finance Bill.

TRUST TAXATION

(i) Rates of tax

Discretionary trusts and accumulation and maintenance trusts will, in general, qualify for a £1,000 standard rate band for tax year 2010/11. Income in excess of this will be taxed at 42½% if dividend income and otherwise at 50%.

(ii) Tax reclaims

In the Budget, the Chancellor announced that where a settlor of a settlor-interested trust receives a repayment of tax:

(a) this tax repayment must be paid to the trustees, and

(b) the payment to the trustees will be disregarded for IHT purposes

By way of background, for income tax purposes, a settlor-interested trust is one under which the settlor or settlor's spouse is a beneficiary. With settlor-interested trusts, the settlor is liable for all income tax due on income received by the trustees, even income that is not paid out to the settlor. However, the trustees are required to pay the tax as the recipients of the income.

With the rates of income tax for discretionary trusts increasing to 42.5% (dividends) and 50% (other income) from 6 April 2010, it will frequently be the case that the tax paid by the trustees will be greater than the tax liability of the settlor and so a tax reclaim will be appropriate.

In such circumstances, this new Budget provision will mean that, from 6 April 2010, the tax repayment must be paid to the trustees but it will be disregarded for IHT purposes.

LIFE POLICYHOLDER TAXATION

Changes to how deficiency (loss) relief is given have been made following the introduction of the additional 50% rate of income tax from 6 April 2010.

When a chargeable event gain calculation takes place on the termination of a life assurance policy and this gives rise to a deficiency (ie. a loss), that deficiency can be attributed to income of the policyholder subject to tax in the same tax year. The amount of the deficiency that can be so attributed is restricted to an amount not exceeding previous chargeable event gains under the same policy (regardless of whether any tax was actually paid on those previous chargeable event gains) that have arisen to the person on whom any chargeable event gain arising on termination, if there were one, would be assessed to tax.

Deficiency relief is given by way of a tax reduction but is not available for policies owned by companies, policies held in a trust created by a company or policies held in trust where the tax liability falls on the trustees.

For tax year 2009/10, in order to calculate the tax reduction, the deficiency is attributed first to income subject to the dividend upper rate then income subject to the 40% upper rate. The amount of tax due on this income is then compared to the amount of tax on that income calculated at the dividend ordinary rate or basic rate, as appropriate. The excess is the tax reduction available.

The rules applies in the same way to those who own non-UK policies, even though they will not have been entitled to the 20% tax credit.

With the introduction of the 50% additional rate of income tax and 42.5% dividend additional rate, a deficiency which arises on a chargeable event on termination which occurs on or after 6 April 2010 will be attributed to income in the following order:-

First: Income subject to the 42.5% dividend additional rate

Second: Income subject to the 50% additional rate

Third: Income subject to the 32.5% dividend upper rate

Fourth: Income subject to the 40% upper rate

The amount of tax due on this income is then compared to the amount of tax on that income calculated at the dividend ordinary rate or basic rate, as appropriate. The excess is the tax reduction available.

An anti-avoidance measure will be introduced which will apply to termination chargeable events occurring on or after 6 April 2010. This will prevent deficiency relief applying where the main purpose, or one of the main purposes, of arrangements made on or after 22 April 2009 is to secure a tax advantage.

Such a tax advantage will be secured where there is a deficiency and the amount of the tax reduction would exceed the "related income tax liability". The related income tax liability is the tax liability on all previous chargeable event gains under the same policy less any basic rate tax credits that were available.

Where this provision applies deficiency relief will not be given at the additional rates but will be restricted to the tax due on previous gains ie. the related income tax liability.

The provision will not apply where any gain included in the total amount of all previous chargeable event gains arose on a chargeable event more than five years before the termination event.

STAMP DUTY LAND TAX (SDLT)

- The SDLT rate is 1% for residential purchases where the consideration is more than £125,000. However, the Chancellor announced that for completions that take place on or after 25 March 2010 and before 25 March 2012, where the purchaser(s) are first-time buyer(s) and intend to occupy the property as their only or main home, relief will apply so that no SDLT will be payable if the consideration does not exceed £250,000. This issue of who is and who is not a "first-time buyer" would, in some cases, be quite complex.

- The highest SDLT rate of 4% applies to a property purchase where the consideration is more than £500,000. For completions that take place on or after 6 April 2011, the Chancellor announced that a rate of 5% will apply where the consideration is more than £1 million.

CAPITAL ALLOWANCES

Few changes were announced to the system of capital allowances in this Budget. The most relevant announcement was the doubling of the annual investment allowance (AIA). This means that from 1 April 2010 (for those chargeable to corporation tax) or 6 April 2010 (for all others) the AIA will increase to £100,000.

The AIA is available to:

- any individual carrying on a qualifying activity (this includes trades, professions, vocations, ordinary property businesses and individuals having an employment or office);

- any partnership consisting only of individuals; and

- any company (subject to certain limitations).

Where businesses spend more than £100,000 in any chargeable period, any additional expenditure will be dealt with under the normal capital allowances regime, entering either the special rate or main pool, where it will attract writing down allowances (WDAs) at the appropriate rate. It should be noted that the special 40% WDA no longer applies from 1 April 2010 for companies and 6 April 2010 for businesses within the charge to income tax.

PENSIONS

The main Budget pension highlights are:

- The restrictions on pension tax relief for high income individuals will go ahead from 6 April 2011, assuming the Government is re-elected.

- Changes are to be made to the pension taxation rules to resolve a number of issues regarding the launch of the National Employment Savings Trust (NEST) and the automatic enrolment provisions.

- Confirmation of the restriction of the standard lifetime allowance and annual allowance at their 2010/11 levels for the following five tax years.

In addition to the Budget changes significant other changes have been announced in the last month or so. The most important of these changes, which concerns block transfers, is considered at the end of this section. The other changes will be covered in the next bulletin.

Tax relief restrictions for high income individuals (2011/12 onwards)

From April 2011 tax relief on pension contributions will be restricted for individuals with gross incomes of £150,000 and over (where gross income incorporates all pension contributions, including those provided by an employer). Tax relief will gradually be tapered away (the Government has decided that a stepped taper of one per cent of relief for every £1,000 of gross income is the most appropriate way to taper down the rate of relief available and intends that legislation in Finance Bill 2010 will reflect this) so that for those with incomes of £180,000 and over it is worth 20 per cent, the same rate received by a basic rate taxpayer. To provide more certainty for individuals around whether they are affected, and to reduce administrative burdens for schemes, this will be subject to an income floor at £130,000 of pre-tax income (excluding the value of any employer pension contributions).

The Government issued a consultation document, alongside the 2009 Pre-Budget Report, on how it proposed to apply the restricted tax relief from April 2011, and it has now published its response to that consultation. The Government's main proposals have remained largely unchanged.

The Government intends to legislate for the core aspects of the policy in the Finance Bill 2010. These are:

- who the restriction will apply to – that is, the income definitions and thresholds, and how the taper will operate to determine the rate of relief to which individuals are entitled; and

- what the restriction applies to – that is, both an individual's own pension contributions, and those made for their benefit by an employer, with the age related factors (ARFs) method being used to value the deemed contribution to a defined benefit (DB) pension scheme. Details of the scale of ARFs will be issued ahead of the introduction of the restriction.

The Government intends to consult further on a number of issues raised during the consultation and will consult further on these. The aspects it will consider further include:

- How a redundancy payment should be assessed when calculating relevant income. At present the Government is minded only to exempt the first £30,000 non-taxable element of the redundancy payment although it "will consider the options raised by stakeholders and will bring forward regulations if it judges that these can balance the interests of fairness without creating avoidance opportunities."

- How the restriction of relief should apply in the year a member draws benefits. The basis to apply in such cases will be set out in the Finance Bill 2011.

The confirmation that the new restricted relief provisions are to go ahead from April 2011 makes it even more important for high income individuals to take full advantage of the pension contribution/accrual opportunities that apply under the anti-forestalling (special annual allowance) provisions.

Auto enrolment/NEST related changes

The following taxation changes are to be made in a Finance Bill, to be introduced as soon as possible in the next Parliament, to deal with a number of issues arising as a result of the introduction of NEST and the automatic enrolment provisions:

- Pension schemes must be registered under Part 4 of the Finance Act 2004 for their members and contributing employers to benefit from tax relief on contributions and investment growth. This change will enable NEST to register with HMRC for tax purposes, and be subject to the same tax rules as other tax registered schemes.

- Under the automatic enrolment provisions, due to start taking effect from October 2012, an employer will be required to pay at least minimum contributions in respect of automatically enrolled jobholders. Where such contributions are paid late (ie. generally after the 19th day of the month following that in which they were due) the employer may, at the discretion of the Pensions Regulator, be asked to pay interest to their jobholder's pension account. Under section 369 of the Income Tax (Trading and Other Income) Act 2005 the jobholder would be taxed on any such interest paid by his employer. The changes in the legislation will remove this tax charge on the jobholder.

- To provide a regulation-making power to deal with any unintended tax consequences that may emerge as a result of the implementation of NEST and the introduction of the employer duties regarding automatic enrolment.

- Under the current rules, borrowing repaid out of the sums or assets of a registered pension scheme will incur a tax charge if it exceeds half of the value of the fund. Changes will be made so that borrowing linked to the cost of establishing and operating a registered pension scheme will be excluded from this charge, subject to certain conditions.

Taxation changes

The Registered Pension Schemes (Standard Lifetime and Annual Allowances) Order 2010 – SI 2010/922 confirms that the standard lifetime allowance and the annual allowance will be capped at their respective levels of £1.8 million and £255,000 applicable in tax year 2010/11 for the immediately following five tax years (ie. up to and including tax year 2015/16).

It has also been confirmed that other benefits which are determined in relation to the standard lifetime allowance (e.g the trivial commutation limit and those with scheme specific protected cash) will also be capped as a result of this restriction.

Although not referred to in this Budget, the following tax changes, announced in the 2009 Pre-Budget Report, take effect from 6 April 2010:

- The rates for the tax charge on short service lump sum refunds and EFRBS payments (other than to individuals) are to be increased, while new rates for the special annual allowance charge apply with effect from 6 April 2010.

    - A tax charge arises where a registered pension scheme repays tax-relieved pension contributions to a member who has completed less than two years' service. The pension scheme deducts tax currently at 20 per cent on the first £10,800 of the refunded contributions and 40 per cent thereafter. Regulations have changed the rates to 20 per cent on the first £20,000 and 50 per cent thereafter on refunds made on or after 6 April 2010.

    - A tax charge is payable where certain lump sums, gratuities or other benefits are received from an EFRBS by an entity who is not an individual. The tax charge is payable by the recipient and the rate is currently set at 40 per cent. This rate will be increased to 50 per cent for benefits received on or after 6 April 2010.

- Where a special annual allowance charge arises in respect of tax year 2010/11 it will be set at the 'appropriate rate'. The 'appropriate rate' is determined by the rate of tax relief given on the amount of their pension savings which exceeds their special annual allowance and will restrict tax relief on that excess to the basic rate of income tax.

Trivial commutation

The Budget 2008 announced changes to the tax rules to enable small occupational pension pots (£2,000 or less) to be taken as a lump sum, which were introduced by the Registered Pension Schemes (Authorised Payments) Regulations 2009 – SI 2009/1171. The Government did not extend the same flexibility to non-occupational pension schemes in order to minimise avoidance. However, the Government has indicated it remains open to proposals for further simplification provided they would not increase Exchequer costs or add significant costs for HMRC, and would not be open to manipulation.

The Government is also open to proposals consistent with these principles for couples to pool small pension pots to achieve better value by purchasing a joint life annuity.

State benefits

Although the basic state pension is normally increased in April each year, based on the increase in the RPI in the year to the previous September, it will in April 2010 be increased by 2.5% as the RPI was negative in September 2009. The revised weekly figures are £97.65 for a single person and £156.15 for a married couple.

The pension credit figures will also be given an above inflation increase to:

- Guarantee credit
  £132.60 pw (single person),
  £202.40 pw (married couple)

- Savings credit threshold
  £98.40 pw (single person)
  £157.25 pw (married couple)

Although not announced in the Budget or the 2009 Pre-Budget Report the following significant changes to state pension benefits take effect from 6 April 2010:

- The commencement of the gradual increase in the female state pension age, which will be equalised with the male state pension age at 65 by 6 April 2020.

- The reduction in the number of qualifying years for a person reaching state pension age on or after 6 April 2010 to qualify for a full rate basic state pension. Such an individual will only need 30 qualifying years.

- The removal of the current minimum National Insurance contribution conditions required to obtain a basic state pension.

- The introduction of new weekly credits for parents and carers replacing the previous home responsibilities protection provisions.

- The abolition of adult dependency increases in respect of the basic state pension.

- A change in the rules to enable husbands and civil partners (as well as wives) to get a basic state pension based on a spouse's or civil partner's National Insurance contribution record. This will apply from 6 April 2010 provided the spouse/civil partner, whose National Insurance record is being used for this purpose, was born on or after 6 April 1950.

- The merging of the middle and upper bands of State Second Pension accrual into one band accruing at 10% in respect of an individual's earnings between £14,100 and £40,810 (ie. 53 x the upper accrual point of £770 per week).

Risk sharing

The Government has taken steps to simplify pension regulation, through the deregulatory review of private pensions, and remains committed to supporting innovation in the development of risk sharing arrangements between employers and employees. In order to inform choices about future pension provision, the Government will shortly publish an Information Note to help employers understand available risk sharing options. The Government will continue to work with industry to explore further facilitation of risk sharing between employers and employees, in both defined benefit and defined contribution pension schemes.

Block transfer definition extended

When the current pension rules were introduced in April 2006, transitional provisions were made to protect the benefits of those members whose pre A-Day entitlement would otherwise have worsened as a result of the new rules. Provided certain conditions were met, such members were able to protect the right to their pre A-Day cash (scheme specific protected cash) and/or their right to draw their benefits prior to the normal minimum pension age (50/55 from 6 April 2010). 'Block transfer' provisions were also included to enable such members to retain their right to these protected benefits where their benefits were transferred from one scheme to another. These 'block transfer' provisions could apply either:

- Where a so-called 'buddy transfer' applies (ie. where at least two members transfer their benefits at the same time from one scheme to another), or

- Where a member's benefits are transferred to an individual deferred annuity (ie. s32 contract) where the member's occupational scheme, relevant statutory scheme or deferred annuity contract has wound up. (the 'scheme wind up' option)

The provisions of the 'scheme wind up' option have now been extended by the Pension Schemes (Transfers, Reorganisations and Winding Up) (Transitional Provisions) Order 2010 – SI 2010/529. These extend the protection offered on scheme wind up to the assignment of the member's benefits to a policy in the member's name.

These Regulations also enable the protection on scheme wind up to be extended to any scheme under which the member held scheme specific protected cash and/or a protected pension age rather than the restricted range of schemes previously applicable. This change means that a member of a wound up personal pension or SIPP could also take advantage of these provisions. In practice this change is unlikely to be that significant as relatively few members are likely to be in receipt of protected cash under a personal pension/SIPP as this would only apply where such benefits had been transferred to the scheme from an occupational scheme under which the member had scheme specific protected cash. In addition, except in those cases where a SIPP is set up under an individual trust, it is highly unlikely that a personal pension/SIPP will be wound up.

The changes have retrospective effect to 6 April 2006.

THE FINANCE BILL 2010

The Finance Bill was published on Thursday April 1. The comments in this bulletin are based solely on information made available at the time of the Budget. Changes may take place as a result of the Finance Bill.

The Finance Bill had to be passed into law before the dissolution of Parliament. Following pressure from opposition MPs some changes had to be made. One such change is the reversal of the move to repeal the furnished holiday lettings rules which would have meant profits from such lettings being taxed in the same way as income from other property rather than as earned income.

It is important to note that the high income excess relief charge for pensions, which is due to begin on 6 April 2011, remains as part of the Bill.