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BUDGET ISSUE CONTENTS

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INTRODUCTION

George Osborne's second Budget marked the first of a new style of Budgets, with a more considered legislative approach.

The 2011 March Budget was different because, in the best of political traditions, so many planned tax increases and reforms had already been announced thanks to December publication of more than 500 pages of draft Finance Bill 2011 legislation and accompanying notes. The previous three Budgets – Mr Osborne's first and Alistair Darling's final pair – all contained promises of pain deferred. For example, in his first Budget, Mr Osborne nodded through no less than 31 tax measures announced by Mr Darling.

There were still a few surprises in the Chancellor's speech though – the increase in the EIS investment limit, the 1% further reduction in the main rate of corporation tax and the doubling of entrepreneurs' relief to £10 million were three examples.

In this Bulletin we look at all of the main changes taking place for this tax year and those we already knew about. We also look at the other main announcements made in the Budget.

INCOME TAX

1. Rates of tax

Tax year 2011/12

(i) The limit for the 10% starting rate for savings income increases to £2,560.

(ii) The basic rate of income tax remains at 20%. The basic rate limit reduces to £35,000 so that the higher rate tax threshold [ie. the basic rate limit (£35,000) plus the basic personal allowance (£7,475)] is aligned to the Upper Earnings Limit for NICs of £42,475.

(iii) The basic rate of tax will apply to income in the band £1 to £35,000. Taxable income in excess of £35,000 will be taxed at 40% or 32.5% (dividends) up to the threshold of £150,000 for the 50% additional rate tax.

(iv) The 50% rate of tax (42.5% for dividends) continues to apply to taxable income in excess of £150,000.

(v) Trustees of discretionary trusts remain subject to income tax at 50% (42.5% on dividend income) on income above their standard rate band (£1,000 maximum, £200 minimum).

2. Personal allowances

- The basic personal allowance is increased from £6,475 to £7,475. Where an individual's adjusted net income exceeds £100,000, the level of the basic personal allowance will be reduced by £1 for each £2 over £100,000 until it reaches zero. This means that the basic personal allowance will reduce to zero where adjusted net income is £114,950 or more.

- The age allowance is £9,940 (for those aged 65 – 74) and £10,090 (for those aged 75 and over).

- The level of income that a person can enjoy before a cut back in age allowance occurs is £24,000, up from £22,900.

- The married couple's allowance (MCA) for those aged 75 and over (provided at least one spouse was aged 65 or over before 6 April 2000) has been increased to £7,295. The MCA for those aged 65 to 74 is no longer relevant. In calculating the reduction in age allowance when income exceeds £24,000, the increased MCA is cut back to not less than £2,800 (the "minimum amount").

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

Budget announcements

(a) Increase in the basic personal allowance for 2012/13

Legislation will be introduced in the Finance Bill 2012 to increase the basic personal allowance for those aged under 65 to £8,105 (an increase of £630) and reduce the basic rate limit to £34,370 (a reduction of £630).

The reduction of the basic rate limit by £630 means that the higher rate tax threshold is not affected by this announcement and remains at £42,475. This ensures no additional higher rate taxpayers are created, and that most basic and higher rate taxpayers will gain from the increase in the basic personal allowance by £126 per annum.

In contrast, in 2011/12, whilst there is an increase in the personal allowance, there will be more higher rate taxpayers because anybody with income of between £42,476 and £43,875 now drops into higher rate tax. This means that for 2011/12 some higher rate taxpayers could be up to £80 worse off. The Government has therefore deliberately avoided this problem in 2012/13 by making a more limited reduction in the basic rate limit at the same time as it increases the basic personal allowance.

(b) CPI Indexation

At present direct tax allowances and bands which are subject to indexation are generally increased each April in line with the change in the RPI for the year to the previous September. For 2011/12 Mr Osborne moved most benefit indexation to the Consumer Prices Index (CPI) and from April 2012 direct taxes will follow. However, for 2011/12 and for the remainder of this Parliament, any income tax personal allowances and limits that are subject to indexation (which excludes the higher rate limit and £100,000 limit), will be increased by a rate that is equivalent to the RPI increase.

(c) Reform of income tax and National Insurance contributions

The Government has announced that it will consult on the options, stages and timing of reforms to integrate the operation of income tax and National Insurance contributions (NICs). In exploring potential reforms the Government aims to remove distortions created by the tax system, reduce burdens on business and improve fairness for individuals. However, it recognises that any change will be complex and involve a wide range of policy and implementation issues. A consultation document will be published later this year setting out the differences in the current income tax and National Insurance systems, and options to address these.

The Government has stated that it will maintain the contributory principle and reflect this in any changes it brings forward. Also, the Government will not extend NICs to individuals above State Pension age or to other forms of income such as pensions, savings and dividends. This could be a considerable challenge.

NATIONAL INSURANCE CONTRIBUTIONS

Tax year 2011/12.

In addition to an increase in the main rates of 1%, the Upper Earnings and Upper Profits Limits (beyond which employee NICs are charged at 2%), have come down from £43,875 to £42,475, in line with the changed starting level for 40% income tax.

Also, the Primary Threshold (the point at which employees start to pay Class 1 NICs) has been reduced to £7,225 so it is broadly aligned with the personal allowance of £7,475.

The rates for 2011/12, as announced by the Treasury in December 2010, are as follows:-

- The Employee's Primary Class 1 National Insurance rate is 12% on earnings between the Primary Threshold (£139 per week - £7,225 pa) and Upper Earnings Limit (£817 per week - £42,475 pa).

- Employees, in addition, pay 2% Primary Class 1 National Insurance on all earnings above the Upper Earnings Limit (£42,475 per annum).

- The Employer's Secondary Class 1 contribution rate on earnings above the Secondary Threshold (£136 per week - £7,072 pa) is 13.8%. This rate applies also to Class 1A and Class 1B contributions.

- The self-employed Class 4 rate on profits between the Lower Profits Limit (£7,225 pa) and Upper Profits Limit (£42,475 pa) is 9% and 2% above £42,475.

Budget announcements

- From 2012/13 most contribution rates, limits and thresholds will be indexed against the CPI and not the RPI.

- The Government announced it will issue a consultation paper later this year on the integration of the operation of income tax and NICs (see above).

CAPITAL GAINS TAX

Tax year 2011/12

- The annual exempt amount has been increased to £10,600.

- The lifetime limit on gains qualifying for capital gains tax (CGT) entrepreneurs' relief is increased from £5 million to £10 million and the rate of CGT for gains qualifying for entrepreneurs' relief remains at 10 per cent.

- For individuals, the rate of CGT remains at 18 per cent where total taxable gains and income are less than the upper limit of the income tax basic rate band (£35,000). The 28 per cent rate applies to gains (or any parts of gains) above that limit. For trustees and personal representatives of deceased persons, the rate of CGT remains at 28 per cent.

Budget announcement

From April 2012 the CPI will be used as the default indexation assumption for the annual exempt amount instead of the RPI that is currently used.

INHERITANCE TAX

Tax year 2011/12

Legislation introduced in the Finance Act 2010 means that the inheritance tax (IHT) nil rate band will remain at its current level of £325,000 for tax year 2011/12 and will remain at this level until 5 April 2015.

Budget announcements

It was widely speculated that a wholesale review of IHT would be announced in the Budget, prompted by the Office of Tax Simplification. That has not happened. However, two changes were announced:

1) From 2015/16 the CPI will be used as the default indexation assumption.

2) For deaths which occur on or after 6th April 2012, a reduced rate of IHT will apply where a deceased leaves 10% or more of his/her net estate to charity. The net estate here is that remaining after deducting any IHT exemptions, reliefs and the nil rate band. In such cases, the usual 40% rate will be reduced by 10% to 36%.

The Government wants to encourage charitable giving and philanthropy and to support the voluntary sector and will be consulting on these provisions. Reducing the rate of IHT by 10% for those who leave 10% or more of their net estate to charity will reduce the cost of giving to charity through bequests. The Treasury documents state that the relief is designed so that the benefit of the tax saving is reflected in the bequests received by charities and not in payments to other beneficiaries.

SAVINGS AND INVESTMENTS

1. Individual Savings Accounts (ISAs)

Tax year 2011/12

For tax year 2011/12 the maximum contribution for all qualifying investors has been raised to £10,680 (of which up to £5,340 may be in cash).

Budget announcement

The basis of indexing the ISA limit will change from an RPI to a CPI basis from 6 April 2012.

2. Junior ISAs

Budget announcement

On 26 October 2010 the Government announced that it would introduce a new tax-advantaged account for saving for children, to be known as a Junior ISA. Draft secondary legislation for the establishment and operation of Junior ISAs has been published alongside the Finance (No.3) Bill 2011. It is expected that Junior ISAs will be available from 1 November 2011 for any UK-resident child (under the age of 18) who does not currently hold a Child Trust Fund account. The Government will be consulting informally with stakeholders on the draft legislation during the spring of 2011.

Junior ISAs will be tax-relieved and will have many features in common with existing ISA products. They will be available as a cash or stocks and shares product and the maximum investment will be £3,000 per annum with no minimum.

The aims of the Junior ISA scheme are to provide families with a simple, transparent, accessible and competitive product to save for children who do not have a CTF account; and create the conditions for families to save more for their children than they otherwise would.

3. Venture capital schemes

Tax year 2011/12

- Subject to State aid approval, the rate of income tax relief given under the Enterprise Investment Scheme (EIS) increases from 20% to 30% with effect from 6 April 2011.

- Changes to the venture capital trust (VCT) and EIS rules to meet EU State aid requirements, effective from 6 April 2011, are as follows:-

  1. An increase in the minimum amount that a VCT must hold in shares. Currently '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% for new VCT share capital *raised* on or after 6 April 2011.

  2. It will become possible for a VCT to be listed on any EU/EEA investment market rather than being limited to a UK listing.

  3. The definition of VCT "eligible shares" will be extended to include shares which may carry certain preferential rights.

  4. Shares in companies that are 'in difficulty' will cease to be qualifying for the purposes of the VCT and EIS rules.

  5. For EISs and VCTs, the existing requirement that a company must have a qualifying trade carried out wholly or mainly in the UK will change to one that it need only have a permanent establishment in the UK.

By far the most significant change is the first one, which will restrict the scope for creating 'limited life' VCTs, designed to return investment as soon as possible after the five year tax relief claw back period ends. Such schemes generally minimise their equity content and invest mainly in loan capital.

Budget announcements

Subject to State aid approval, the following changes to the EIS and VCT from 6 April 2012 have been proposed:

- an increase in the thresholds for the size of qualifying company for both EISs and VCTs to fewer than 250 employees and to the company having no more than £15 million of gross assets before the investment;

- an increase in the annual amount that can be invested through both EISs and VCTs in an individual company to £10 million; and

- an increase in the annual amount that an individual can invest in EIS investments in a tax year to £1 million.

The Government will consult on further changes to the schemes, including proposals to give additional support through the EIS for seed investment.

CHARITIES

Tax year 2011/12

- The SA Donate scheme is withdrawn for repayments of tax due on tax returns for 2011/12 and subsequent years because of insufficient use.

- New rules aimed at clarifying the "substantial donors" anti-avoidance legislation take effect from 6 April 2011. This legislation applies where a donor enters an arrangement with the main purpose of obtaining a financed advantage from the charity.

Budget announcements

- From 6 April 2012, there will be a facility to obtain a reduced rate of IHT via a charitable legacy – see the Inheritance Tax section.

- From 6 April 2013, within limits and subject to restrictions to be consulted on, charities will be able to claim a repayment of tax without obtaining Gift Aid declarations from donors. Also from this date the limits on donations that can be made without barring a donor from receiving a benefit from the charity will be increased.

PENSIONS

Tax year 2011/12

As readers will be aware numerous changes are taking place which have been covered in earlier Bulletins.

Budget announcements

It was something of a relief to see relatively few pension changes in the Budget. The main changes are:

- The Government will look to reform the state pension for future pensioners so that it provides simple, contributory, flat-rate support above the level of the means-tested Guarantee Credit. The DWP has published a Green Paper to consult on the options for reform, which will include a proposal for a single tier pension, currently estimated to be worth around £140 per week. If it is decided to move to single tier provision, this would result in the end of contracting out on a DB basis earlier than currently anticipated.

- Following the bringing forward of the increase in the State Pension Age to 66 by April 2020, the Government will be bringing forward proposals to manage future changes in the

State Pension Age more automatically, including the option of a regular independent review of longevity changes.

- The Government has announced that it accepts the recommendations in the Hutton report on public sector pensions as a basis for consultation with public sector unions. It intends to set out proposals for change in autumn 2011.

- The Government has indicated that during the consultation on the draft Finance Bill 2011 clauses to remove the effective requirement to annuitise at age 75, some unintended differences in the pensions and lump sums payable before and after age 75 were identified. Changes have been made to the draft legislation to remove these differences. It has also indicated that members who have reached age 75 will be allowed to align multiple drawdown pension funds under the same scheme so the funds can all be valued annually on the same date.

- The Government has indicated that there will also be some revisions to the draft Finance Bill 2011 legislation regarding the reduction in the annual and lifetime allowances to ensure the legislation meets the stated policy objectives.

- The Government will consult on changing tax rules to limit the amount of tax relief available to employers when they make asset-backed contributions to their defined benefit pension schemes so that the tax relief accurately reflects the increase in fair value of pension plan assets, whilst maintaining flexibility for employers and schemes. The consultation document will be published in spring 2011. Subject to the consultation, legislation will be introduced in Finance Bill 2012.

LIFE POLICYHOLDER/LIFE COMPANY TAXATION

- ### Life policyholder taxation

No changes were announced.

- ### Solvency II and the taxation of insurance companies

A new life insurance tax regime will come into being from 1 January 2013. The new regime will deal with essential adjustments arising from Solvency II and at the same time deliver significant changes to create a simpler and more stable tax basis better aligned with the taxation of insurance companies generally.

- ### Protection life insurance

Changes will be made to the way in which life insurance companies are taxed on certain long-term business. The “income minus expenses” method used to calculate the profits on those life insurance policies which primarily provide protection in the event of death will not apply to policies written after 31 December 2012. Instead, life insurance companies will be taxed on a trading profits basis.

- **Consultation**

For both of the above changes, the Government will be consulting further in April.

BUSINESS TAX

Financial year commencing 1 April 2011

The rates of corporation tax will be as follows:

- The small profits rate of corporation tax for companies with profits up to £300,000 will be reduced to 20%. This change was announced in the June 2010 Budget.

- The main rate of corporation tax for companies with profits of £1,500,000 or more will be reduced to 26% not 27% (as was announced in the June 2010 Budget). With the rate set to reduce by 1% per annum, this means that for the financial year starting 1 April 2014 the rate will have reduced to 23%.

- For profits of 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 profits rate of 20% and the main rate of 26%. Profits in excess of £300,000 up to £1,500,000 will effectively bear tax at the marginal rate of 27.5%.

Budget announcements

- The Controlled Foreign Company (CFC) regime is to be fully reformed with new rules introduced in Finance Bill 2012. The aim of the reform is to make the CFC regime more competitive while providing adequate protection for the UK corporation tax base. A consultation document will be published in May 2011 and draft legislation in autumn 2011.

- Before the Budget, the Office of Tax Simplification had published a small business tax review. This had suggested the abolition of IR35, the controversial legislation aimed at personal service companies. Unfortunately, the Budget contained a statement that IR35 would not be abolished, although the Government committed to making 'clear improvements' in the way it is administered.

CAPITAL ALLOWANCES

Financial year commencing 1 April 2011/tax year 2011/12

- The Annual Investment Allowance, which gives 100% initial relief for investment in plant and machinery, continues at 100% but will drop from £100,000 to £25,000 from April 2012 as announced in last June's Budget.

The main writing-down allowances continue at 20% for expenditure allocated to the main rate pool, and at 10% for expenditure allocated to the special rate pool but will drop by 2% from April 2012 as also announced last June.

Budget announcements

- Legislation will be introduced in the Finance Bill 2011 to enable businesses incurring expenditure on an item of plant or machinery from April 2011 onwards to make a short life asset election in respect of that item if they expect to sell or scrap it within an eight-year cut-off period. This is an extension from the current four year period.

- The energy-saving enhanced capital allowance scheme will, subject to State aid approval, be updated during summer 2011.

DOMICILE AND RESIDENCE

Tax year 2011/12

No major changes were announced.

Budget announcements

As well as announcing the commencement of consultation with a view to creating a statutory test of residence, further reform to the taxation of the foreign income and gains of UK resident non-domiciliaries (non-doms) was proposed.

Broadly speaking, under the law as it stands, certain UK resident non-doms are subject to tax on their foreign income and gains as they arise, whether they are brought into (remitted) to the UK or not. However, the payment of a £30,000 so-called remittance basis charge each year absolves them of the need to pay UK tax on foreign income and gains unless they remit such income or gains to the UK.

From 6 April 2012 the Government has proposed that the existing £30,000 annual charge should increase to £50,000 for non-doms who have been UK resident for 12 or more tax years and who wish to retain access to the remittance basis. The £30,000 charge will be retained for those who have been resident for at least seven of the past nine tax years and fewer than twelve tax years.

In addition, the Government is looking to simplify some aspects of the current tax rules for non-doms to remove undue administrative burdens and remove the tax charge when they remit foreign income or capital gains to the UK for the purpose of commercial investment in UK businesses. This is designed to address the disincentive to inward investment in the UK.

FURNISHED HOLIDAY LETTINGS

Tax year 2011/12(and 2012/13)

From 6 April 2011, business expenses can only be offset against rental income from the same furnished holiday letting business. If an excess arises it can only be carried forward for offset against rental income arising in the future from the same business. From 6 April 2012 the rules on what qualifies as a holiday letting business are tightened.

TAX AVOIDANCE, DISGUISED REMUNERATION AND TAX SIMPLIFICATION

This section deals with measures that will be relevant to financial planners.

Anti-avoidance proposals

- **SDLT**: See SDLT section earlier.
- **High risk areas:** The Government has announced the first reviews in the programme of work to strengthen tax law in areas that have repeatedly been subject to avoidance attempts.
- **Listed tax avoidance schemes:** This measure seeks to reduce the cash flow advantage from using certain avoidance schemes. The aim is to deter the use of such schemes by listing them in regulations and attaching statutory consequences to their use.
- **Employer asset-backed pension contributions** is dealt with in the pensions section.

Disguised remuneration

On 9 December 2010, the Government announced that legislation would be introduced in the Finance Bill 2011 to prevent employees from gaining a tax advantage on third party arrangements that seek to avoid or defer the payment of income tax or NICs due on employment income or avoid restrictions on pensions tax relief. It was anticipated this would apply to benefits received by certain types of trust established by their employer on their behalf. Typically this could apply to payments to EFRBS and interest-free loans made from EBTs.

Following consultation with interested parties the Government announced in the Budget that it had become clear that the original draft legislation was too broad and that arrangements which were outside the scope of the policy intention were inadvertently caught. To deal with this issue, the Government has amended the legislation to limit impacts on employers and individuals where it is possible to identify arrangements that cannot be used for avoidance purposes. This includes the protection of rewards provided by group companies, share incentive arrangements and genuine deferred remuneration arrangements. In addition, the Government intends to protect investment income and gains, and to exclude existing pension savings.

However, the main thrust of these changes remain and in light of these changes employers/employees will need to turn their attention to other methods of providing tax effective employee benefits. Clearly, a contribution to a registered pension scheme will be the main and most tax efficient method of employee retirement provision. Here aggregate contributions of up to £50,000 (and possibly more if advantage can be taken of the annual allowance carry forward provisions) are permitted with full tax relief for pension input periods ending in tax year 2011/12.

The new tax simplification proposals

The Office of Tax Simplification (OTS) was commissioned to undertake a review of the reliefs and allowances available in the tax system. Following the publication of the OTS's report in March 2011 the Government has decided to abolish a number of reliefs, though not all at the same time.

STAMP DUTY LAND TAX (SDLT)

Tax year 2011/12

There were no changes to the SDLT rates announced in the Budget. As a result:

- The normal residential property SDLT threshold remains at £125,000 (£150,000 for non-residential properties).
- The new 5% SDLT rate will apply on residential property purchases above £1m from 6 April 2011.
- The first-time buyer SDLT threshold of £250,000 is due to continue for another year, ending on 24 March 2012.

Budget announcement

The Chancellor did announce new SDLT anti-avoidance measures. This was only to be expected, as SDLT avoidance schemes have become widespread and since 1 April 2010 all schemes involving residential property with a value of at least £1m have had to be disclosed to HMRC.

INCOME WITHDRAWAL RATE FOR APRIL 2011

The appropriate gilt yield, used to determine the 'relevant annuity rate' from HMRC's tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in April 2011 is 4.0%.

As usual, the contents of this Bulletin are based solely on the proposals put forward by the Chancellor in his March 2011 Budget and need to be approached with caution as details may change during the passage of the Finance Bill through Parliament.