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BUDGET ISSUE CONTENTS

Published by Technical Connection Ltd,
7 Staple Inn, London, WC1V 7QH.
Tel: 020 7405 1600 Fax: 020 7405 1601
E-mail: enquiries@technicalconnection.co.uk
www.techlink.co.uk

INTRODUCTION

In the run up to George Osborne's third Budget there were plenty of rumours about what he *might* do, ranging from introducing a mansion tax to abolishing higher (and additional) rate tax relief on pension contributions. In the event, many of the rumours proved to be just that – rumours although some did "come to pass".

Despite this there were important announcements, for example, on

- Income tax rates.
- Personal allowances.
- Anti-avoidance tax rules on single premium bonds.
- An indirect restriction on premiums to qualifying life policies.
- A revised income threshold of £50,000 above which the benefits of Child Benefit are gradually lost.
- An enhanced reduction in the main corporation tax rate.
- Changes to Stamp Duty Land Tax.

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 2012/13

(i) The limit for the 10% starting rate for savings income increases to £2,710.

(ii) The basic rate of income tax remains at 20%. The basic rate limit reduces to £34,370 so that the higher rate tax threshold [ie. the basic rate limit (£34,370) plus the basic personal allowance (£8,105)] remains 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 £34,370. Taxable income in excess of £34,370 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 £7,475 to £8,105. 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 £116,210 or more.

- The age allowance is £10,500 (for those aged 65 – 74) and £10,660 (for those aged 75 and over).

- The level of income that a person can enjoy before a cut back in age allowance occurs is £25,400, up from £24,000.

- The married couple's allowance (MCA) for those aged 75 and over (provided at least one spouse was born before 6 April 1935) has been increased to £7,705. In calculating the reduction in age allowance when income exceeds £25,400, the increased MCA is cut back to not less than £2,960 (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) Reduction in additional rate tax from 6 April 2013

The Government believes that, because of taxpayer behaviour, the 50% tax rate is not yielding the amount of tax it was expected to when it was introduced. It is also thought that the 50% tax rate may be having a negative impact on the economy. In light of this the Government has announced that legislation will be introduced in the Finance Bill 2012 to reduce the additional rate of tax from 50% to 45% with effect from 6 April 2013. At that time the additional rate in respect of dividend income will be 37.5% and the trust rate will be 45% (with 37.5% payable on dividends).

The charge on benefits paid to non-individuals under an employer-financed retirement benefits scheme will reduce from 50% to 45%. Where capital sums are deemed to be income of a settlor, the rate of tax taken as paid by the trustees will also reduce from 50% to 45%.

Basic rate tax will remain at 20% and higher rate tax 40% in 2013/14.

(b) Increase in income tax personal allowance for 2013/14 (under age 65)

Legislation will be introduced in Finance Bill 2012 to set the personal allowance for those aged under 65 at £9,205 and the basic rate limit at £32,245 with effect from 6 April 2013.

The reduction to the basic rate limit means the higher rate threshold (the sum of the personal allowance and basic rate limit) is reduced to £41,450. All basic rate taxpayers will gain from the increase in personal allowances. Indeed, nobody will become a higher rate taxpayer simply because of the change. The income tax benefits to a higher rate taxpayer are marginal. However, HMRC claims that higher rate taxpayers will benefit from 25% of the savings of basic rate taxpayers if the reduction in the NICs Upper Earnings Limit and Upper Profits Limit is taken into account.

In 2011/12, whilst there was an increase in the personal allowance, there were more higher rate taxpayers. The Government is deliberately avoiding this problem in 2012/13 by making a sufficient reduction in the basic rate limit. It is clear that it is also seeking to avoid this problem in 2013/14.

(c) Changes to age allowance for 2013/14 (65 or over)

From 2013/14, the amounts of the age-related personal allowances will not be increased.

Legislation will be introduced in Finance Bill 2012 to provide that from the 2013/14 tax year:

- people born after 5 April 1948 will be entitled to the basic personal allowance of £9,205 for 2013/14;
- people born after 5 April 1938 but before 6 April 1948 will be entitled to a personal (age) allowance of £10,500; and
- people born before 6 April 1938 will be entitled to a personal (age) allowance of £10,660.

The availability of the age-related income tax personal allowances will be restricted because, with effect from 2013/14, people born after 5 April 1948 will only be entitled to the basic personal allowance (£9,205 for 2013/14). Because age allowance is frozen and the basic personal allowance is increasing, eventually there will be a single personal allowance for all taxpayers.

These higher allowances are subject to an income limit so that where an individual's income exceeds £25,400 (in 2012/13), their personal allowance is reduced by £1 for every £2 above the income limit. However, irrespective of the level of income, age allowance is not reduced below the amount of the personal allowance for people aged under 65 (£8,105 for 2012/13). There is an exception for people with incomes exceeding £100,000, where a separate reduction applies to the individual's personal allowance, regardless of their age.

It is assumed that the provisions that apply a reduction in the age allowance because of a person's income will continue to apply in the future until age allowance is aligned with the basic personal allowance.

(d) Reform of income tax and national insurance contributions

As part of its drive towards producing a simpler tax system, the Government has announced in this year's Budget that it will launch a detailed consultation on integrating the operation of income tax and NICs. This will be published after the Budget and build on extensive work undertaken with stakeholders through 2011. It will set out a broad range of options for the operation for employee, employer and self-employed NICs.

(e) Child Benefit – income tax charge for claimants with higher income

Legislation will be introduced in Finance Bill 2012 that applies a new income tax charge to taxpayers who receive Child Benefit themselves or whose partner receives Child Benefit. The charge will only apply to taxpayers whose income is more than £50,000 for the tax year. If both partners have income of more than £50,000 for the tax year, the charge will apply only to the partner with the higher income. Partners for this purpose include married couples, civil partners, unmarried couples and same-sex couples not in a civil partnership. The new rules will start on 7 January 2013.

For taxpayers whose income is between £50,000 and £60,000, the amount of the charge will be 1% of the amount of Child Benefit for every £100 of income that exceeds £50,000. A taxpayer whose income exceeds £60,000 will be liable to the charge on the full amount of Child Benefit and so effectively lose all the advantage of Child Benefit. For example, Child Benefit for two children is £1,752. For a taxpayer whose income is £54,000, the charge will be £700.80 – i.e. £17.52 for every £100 earned above £50,000. For a taxpayer whose income is £60,000 or over, the charge will be £1,752.

An individual who has income above £50,000 but is not entitled to Child Benefit themselves will only be liable to the charge for any period of the tax year during which they are living with a Child Benefit claimant whose own income is below £50,000.

Child Benefit itself is not being made liable to tax and the amount that can be claimed is unaffected by the new charge. It can continue to be paid in full to the claimant even if they or their partner have a liability to the new charge. Child Benefit claimants will be able to elect not to receive the Child Benefit to which they are entitled if they or their partner do not wish to pay the new charge. The claimant may subsequently decide to withdraw that election if they or their partner are no longer liable to pay the charge.

The measure of income that will be used will be the individual's "adjusted net income". This is an existing method of determining an individual's income and is currently used to work out entitlement to personal allowances for someone aged 65 or over or who has income over £100,000.

The amount of the charge will be collected through self assessment and PAYE. Individuals who think they may be affected by these proposals do not need to do anything now. HMRC will be writing to taxpayers with income above £50,000 in the autumn.

NATIONAL INSURANCE CONTRIBUTIONS

Tax year 2012/13

The Upper Earnings and Upper Profits Limits (beyond which employee NICs are charged at 2%) remain at £42,475, in line with the starting level for 40% income tax.

The main rates for 2012/13, as announced by the Treasury in November 2011, are as follows:-

- The Employee's Primary Class 1 National Insurance rate is 12% on earnings between the Primary Threshold (£146 per week - £7,605 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 pa).

- The Employer's Secondary Class 1 contribution rate on earnings above the Secondary Threshold (£144 per week - £7,488 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 (£7,605 pa) and Upper Profits Limit (£42,475 pa) is 9% and 2% above £42,475.

Budget announcement

- The Government announced it will issue a consultation paper after the Budget on the integration of the operation of income tax and NICs.

CAPITAL GAINS TAX

Tax year 2012/13

- The annual exempt amount remains at £10,600.

- The lifetime limit on gains qualifying for capital gains tax (CGT) entrepreneurs' relief is kept at £10 million as is the 10% rate of CGT for gains qualifying for entrepreneurs' relief.

- For individuals, the rate of CGT remains at 18 per cent where total taxable gains and income are less than the basic rate limit (£34,370). The 28 per cent rate applies to gains (or any parts of gains) above this limit. For trustees and personal representatives of deceased persons, the rate of CGT remains at 28 per cent.

Budget announcement

From April 2013 it is planned to extend the CGT regime to gains on disposals by non-UK resident persons of UK residential property and shares or interests in such property. The rules only apply to taxpayers who aren't individuals (eg they are companies).

INHERITANCE TAX

Tax year 2012/13

The inheritance tax (IHT) nil rate band will remain at its current level of £325,000 for tax year 2012/13 and until 5 April 2015. A reduced tax rate of 36% on death will be available in respect of deaths occurring on or after 6 April 2012 where at least 10% of a net estate (before deducting charitable legacies) is left to charity.

Budget announcements

- The only specific new measure as regards inheritance tax that was announced in the Budget was the anti-avoidance measure dealing with IHT avoidance by means of the acquisition of interests in excluded property trusts.

- The Government will consult on legislation to increase the IHT-exempt amount that a UK domiciled individual can transfer to their non-UK domiciled spouse or civil partner. At the moment this is limited to £55,000, an amount that has not been raised since it was first introduced.

- The Government will consult on simplifying the calculation of the IHT periodic and exit charges for trusts falling within the relevant property provisions. Legislation will be included in the Finance Bill 2013.

SAVINGS AND INVESTMENTS

1. Individual Savings Accounts (ISAs)

Tax year 2012/13

For tax year 2012/13 the maximum contribution for all qualifying investors has been raised to £11,280 (of which up to £5,640 may be in cash).

2. Venture capital schemes

Tax year 2012/13

The following changes to the EIS and VCT schemes take place from 6 April 2012:-

- 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 new Seed Enterprise Investment Scheme is available from 6 April 2012.

Budget announcements

Measures are to be introduced from 6 April 2012 that will amend the EIS to:

- relax the rules defining when a person is connected to a company through an interest in its capital;

- widen the definition of shares which qualify for relief; and

- remove the £500 minimum investment limit.

The measures also include the removal of the £1 million limit on investment by a VCT in a single company (except for companies in a partnership or a joint venture).

LIFE POLICYHOLDER TAXATION

Two provisions were introduced to prevent:

(i) chargeable event gains made under a policy which cannot give rise to an actual tax charge (ie. because the policyholder is non-UK resident) being available to set against a later gain and so avoid tax and

(ii) cluster arrangements, which have policy segments that have different terms, being used to defer any gains until the encashment of the final policy segment.

These two provisions will take effect in relation to policies made on or after 21 March 2012 and for pre-existing policies where certain events (eg variation resulting in an increase in the benefits secured or assignment of the policy) take place on or after 21 March 2012.

The Government is also to introduce provisions, effective from 6 April 2013, to limit the annual amount that can be paid into a qualifying policy if complete tax freedom is required on the proceeds. This change is intended to retain the current qualifying policy (QP) rules as far as possible but at the same time to impose a cap on the amount of premiums that can be paid into QPs in any twelve month period.

This cap will be £3,600 and, to the extent that premiums under affected policies exceed £3,600 per annum, the part of the notional chargeable event gain that relates to the excess premium payments under an affected policy will be taxable.

This £3,600 limitation will only apply to policies effected on or after 6 April 2013. There will also be transitional provisions affecting policies issued on or after 21 March 2012 and before 6 April 2013 and policies issued before 21 March 2012 that have had their premium paying term extended by exercise of an option or variation on or after 21 March 2012.

There are relatively detailed provisions specifying what will and what won't be caught. Consultation will take place on this change.

The Government also announced that there would be consultation on reform to time apportionment reductions reflecting a policyholder's period of residence outside the UK. Legislation is planned for 2013.

BUSINESS TAX

Financial year commencing 1 April 2012

The rates of corporation tax will be as follows:

- The small profits rate of corporation tax for companies with profits of up to £300,000 remains at 20%.

- The main rate of corporation tax for companies with profits of £1,500,001 or more will be reduced to 24% not 25% (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 commencing 1 April 2014 the rate will have reduced to 22%.

- 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 24%. Profits in excess of £300,000 up to £1,500,000 will effectively bear tax at the marginal rate of 25%.

Budget announcements

To complement the corporate tax changes referred to above the Government is also proposing some important changes to make the tax system simpler for small businesses.

The main changes proposed are centred on:

- A simpler income tax scheme for smaller businesses.

- Making disincorporation easier.

- Improving PAYE reporting for small businesses.

- Making the tax system more transparent.

- Integrating income tax and National Insurance contributions.

PENSIONS

There had been considerable speculation prior to the Budget that there may be an attack on the pension tax reliefs, either by restriction of higher rate relief, a reduction in the current £50,000 annual allowance and/or by a reduction in the allowable pension commencement lump sum. It is therefore pleasing to note that all such speculation was mis-founded and that all the pension reliefs have been left unchanged.

Main Budget announcements

(i) New reporting regime for QROPS

A QROPS is an overseas pension scheme that can receive a transfer of the value of a member's pension fund and pension rights from a UK registered pension scheme. HMRC requires a QROPS to broadly mirror a UK registered pension scheme. So HMRC expects that someone transferring their pension fund to a QROPS would still receive their pension benefits at retirement in much the same way had they kept their pension savings in a UK pension scheme.

In view of the growing evidence that some QROPS have been used to facilitate early access to UK tax relieved pension funds inconsistent with the law, and the increasing marketing of such arrangements primarily as a way to avoid UK tax, HMRC has introduced new reporting requirements for such schemes effective from 6 April 2012. This is to try to ensure that QROPS are being established and operated in a manner that meets the objective of providing the member with their pension entitlement at the point of retirement.

(ii) Contributions paid for spouses or family members

The Government will legislate in the Finance Bill 2013 to ensure that arrangements where an employer pays a pension contribution into a registered pension scheme for an employee's spouse or family member as part of their employee's flexible remuneration package cannot be used to obtain tax and NIC advantages for the employee or the employer. It is unclear from when these changes will be effective (i.e. from the date of the Budget or from some later date).

(iii) State Pension reform

The Government will reform the State Pension into a single tier pension for future pensioners. The new system will be introduced early in the next Parliament and will be set at a level above the means-tested standard Guarantee Credit and all State Pension records will be recognised. As set out in the Green Paper published by the Department for Work and Pensions the single tier will cost no more than the current State Pension system in every year. The Government will bring forward further detail in a White Paper in spring 2012, with final decisions on the detailed implementation of the policy being taken at the next spending review.

The Government will commit to ensuring the State Pension Age is increased in future to take into account increases in longevity and will publish proposals at the time of the OBR's 2012 Fiscal sustainability report.

CAPITAL ALLOWANCES

Financial year commencing 1 April 2012/tax year 2012/13

- The Annual Investment Allowance, which gives 100% initial relief for investment in plant and machinery, drops from £100,000 to £25,000 from April 2012.
- The main writing-down allowances reduce to 18% for expenditure allocated to the main rate pool, and to 8% for expenditure allocated to the special rate pool.

Budget announcements

- Some anti-avoidance legislation on plant and machinery is to be tightened up.
- Anti-avoidance legislation, effective from 21 March 2012, will be introduced in connection with long funding leases for the purchase of plant and machinery.
- The 100% first-year allowance for low emission cars will be extended to 31 March 2015.

CHARITIES

Tax year 2012/13

See commentary on the 10% reduction in inheritance tax in the earlier inheritance tax section.

Budget announcements

The Chancellor announced a number of measures to benefit community amateur sports clubs (CASCs) and other charities.

- **Entitlement to Gift Aid**

Legislation will be introduced in Finance Bill 2012 to amend the CASC and Gift Aid legislation to ensure it operates as originally intended. HMRC has been registering CASCs and allowing Gift Aid payments on a concessionary basis. This legislation will put both concessions onto a statutory basis.

- **In-year repayment of Gift Aid**

Finance Act 2010 put the practice of making in-year repayment of Gift Aid to charitable companies and CASCs onto a statutory basis. Provisions will be introduced in Finance Bill 2012 to amend that legislation to ensure it works as intended.

STAMP DUTY LAND TAX (SDLT)

Budget announcements

The Government has increased the tax charged on high value properties by introducing a new SDLT rate of 7 per cent for residential properties sold for over £2 million. This applies from 22 March 2012.

In order to tackle what the Government terms the "enveloping" of high value properties into companies to avoid paying a fair share of tax, a 15% rate of SDLT will be introduced. It will apply to residential properties sold for over £2 million purchased by non-natural persons, such as companies, collective investment schemes (including unit trusts) and partnerships in which a non-natural person is a partner. This new rate took effect on 21 March 2012. In addition, the Government will consult on the introduction of an annual charge on residential properties valued at over £2 million owned by these non-natural persons with the intention of legislating in Finance Bill 2013 for commencement in April 2013.

TAX AVOIDANCE

This year the Chancellor not only announced a number of specific tax avoidance measures but also a plan to introduce a General Anti-abuse Rule (GAAR).

1. The GAAR

The Government has accepted the recommendation of the Aaronson Report that a GAAR targeted at artificial and abusive tax avoidance schemes would improve the UK's ability to tackle tax avoidance while maintaining the attractiveness of the UK as a location for genuine business investment. The Government will consult with a view to bringing forward legislation in the Finance Bill 2013.

2. The new specific anti-avoidance proposals

The proposals below are those which are not covered in other sections of this Bulletin.

(i) Debt buybacks

Legislation will be introduced in Finance Bill 2012 to amend the corporation tax rules on loan relationships held between connected companies. This was announced on 27 February 2012, with effect from that date.

(ii) Corporate investors in authorised investment funds (AIFs)

The Government has introduced secondary legislation to address a tax avoidance scheme which seeks to obtain tax benefits for a corporate investor in relation to a distribution made by an AIF where no underlying tax has been suffered. This was announced on 27 February 2012 to take effect from that date.

(iii) Inheritance tax: offshore trusts:-

Legislation will be introduced in Finance Bill 2012 to amend the excluded property and settled property provisions in order to close an avoidance scheme involving the acquisition of interests in offshore trusts by UK-domiciled individuals.

(iv) Income tax: corporate settlor-interested trusts

Legislation will be introduced in Finance Bill 2012 in order to close an avoidance scheme involving corporate settlors.

3. The proposed cap on unlimited tax reliefs

Legislation will be introduced in Finance Bill 2013 to apply a cap on income tax reliefs claimed by individuals from 6 April 2013. The cap will apply only to reliefs which are currently unlimited such as charitable donations. For anyone seeking to claim more than £50,000 in reliefs, a cap will be set at 25 per cent of income (or £50,000, whichever is greater). Draft legislation will be published for consultation later this year.

The Treasury and HMRC have recently given further information on the ambit of this new rule. It confirms that the cap won't apply to, for example, notional tax on life assurance chargeable event gains (which would seem to be aimed at the basic rate tax credit for UK life policies), reliefs that are already capped eg pensions tax relief, EIS and VCT investments, and computational reliefs which should, it is hoped, exclude "top-slicing " relief in relation to chargeable event gains under life policies

4. Disclosure of tax avoidance schemes (DOTAS)

The Government will be formally consulting over the summer on extending the hallmarks so as to capture avoidance schemes that do not currently have to be notified, with a view to publishing draft regulations later in the year.

A technical measure will amend the SDLT sub-sales rules from 21 March 2012 to put beyond doubt that an SDLT avoidance scheme, involving the sub-sales rules and an option to purchase land, is ineffective.

INCOME WITHDRAWAL RATE FOR APRIL 2012

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 2012 is 2.75%.

As usual, the contents of this Bulletin are based solely on the proposals put forward by the Chancellor in his March 2012 Budget and need to be approached with caution as details may change during the passage of the Finance Bill through Parliament.